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# Basics Track: Trademarks & IP

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## **I. TRADEMARKS**

Trademarks, often referred to as brands, are central to nearly all commercial activity. Trademarks and trademark law serve numerous important roles, including: (1) helping consumers avoid confusion by identifying and distinguishing the sources of goods and services; (2) increasing economic efficiency by reducing the time, cost, and effort consumers devote to searching for goods and services; and (3) protecting the goodwill and equity that the providers of these goods and services create for their brands.<sup>1</sup>

While all of these roles serve a valuable purpose, the third role is especially critical to franchising, as the franchise relationship is predicated on the ability of the franchisee to leverage the value that customers associate with the franchisor's brand name. In fact, trademarks are so key to the franchise model, they are explicitly referenced as an element in the Federal Trade Commission ("FTC") definition of a "franchise."<sup>2</sup>

Because trademarks and franchising go hand-in-hand, it is important for franchise attorneys to have a basic understanding of trademarks, and trademark law as a form of intellectual property law. This section will: (1) provide a high-level overview of basic trademark concepts; (2) summarize the legal framework of trademark protection offered under common law, state, federal, and international law; and (3) offer practical guidance to franchisors for selecting and using trademarks.

### **A. Basic Concepts**

#### **1. Distinguishing Trademarks, Service Marks, and Trade Dress**

Trademarks are at their most basic level source indicators; however, they come in many different forms.<sup>3</sup> A traditional "trademark" is a word, name, symbol, device, or other designation (or a combination of such designations) that is distinctive of a person's goods and that is used in a manner that identifies those goods and distinguishes them from the goods of others.<sup>4</sup> A "service mark" functions in the same manner as a trademark except that the designator is used to identify services, as opposed to goods.<sup>5</sup>

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<sup>1</sup> See S. Rep. No. 1333, 79<sup>th</sup> Cong., 2d Sess. 3 (1946) (explaining that the two primary justifications for trademark protection are to "protect the public so that it may be confident that in purchasing a product bearing a particular trademark which it favorably knows, it will get the product which it asks for and wants to get" and to ensure that "where the owner of a trademark has spent energy, time, and money in presenting to the public the product, he is protected in his investment from its misappropriation by pirates and cheats"); Daniel M. McClure, Trademarks and Competition: The Recent History, 59 Law & Contemp. Probs. 13, 28-33 (1996) ("The function of trademark law is reduced to a single goal of economic efficiency to maximize wealth"); Jerre B. Swann, Dilution Redefined for the Year 2002, 92 Trademark Rep. 585, 586-618 (2002).

<sup>2</sup> 16 C.F.R. § 436.1 (h)(1).

<sup>3</sup> While there is technically a difference between trademarks, service marks and trade dress (as explained in this paper), the broader terms "trademark" or "mark" is frequently used to refer to all three forms, and is used in that manner in this paper.

<sup>4</sup> 15 U.S.C. § 1127.

<sup>5</sup> 15 U.S.C. § 1127.

“Trade dress” is a form of non-verbal trademark that refers to the “image and overall appearance” of a product or service.<sup>6</sup> Trade dress may include features such as size, shape, color or color combinations, texture, graphics, or even particular sales techniques.<sup>7</sup> In other words, trade dress “embodies that arrangement of identifying characteristics or decorations connected with a product, whether by packaging or otherwise, [that] make[s] the source of the product distinguishable from another and . . . promote[s] its sale.”<sup>8</sup> Ultimately, trade dress functions in a similar manner as a traditional verbal trademark or service mark— it provides a mechanism for consumers to differentiate goods and services and allows manufacturers to advertise their “brand names” through their products’ and services’ designs without fear of competitors passing off imitation goods as originals.

The purposely broad definitions of trademarks, service marks, and trade dress capture everything from brand names (McDonald’s®, Molly Maid®, ReMax®) and logos (the Nike “Swoosh”) to colors (the famous “Tiffany” blue) and sounds (the National Broadcasting Company chimes). A handful of industrious brand owners have also managed to obtain trademark protection for scents.<sup>9</sup> Of particular note to franchisors, trade dress protection has also been extended to the shape of a building and a restaurant’s decor, menu, storefront, physical layout, and style.<sup>10</sup> Several retail outlets have succeeded in obtaining federal registration of storefronts and physical layouts for their concept stores.<sup>11</sup>

## 2. Trade Names

A trade name is a word, name, symbol, device, or other designation that is distinctive of a business and is used in a way that identifies the business and distinguishes it from others.<sup>12</sup> Generally, a trade name is the legal name of a business (such as an entity name, the name of a limited partnership, or the names

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<sup>6</sup> *Two Pesos, Inc. v. Taco Cabana, Inc.*, 505 U.S. 763, 756 n. 1 (1992).

<sup>7</sup> *Id.*

<sup>8</sup> *Abercrombie & Fitch Stores, Inc. v. Am. Eagle Outfitters*, 280 F.3d 619, 629 (6th Cir. 2002).

<sup>9</sup> *Qualitex Co. v. Jacobson Prods. Co.*, 514 U.S. 159 (1995) (observing that “since human beings might use as a “symbol” or “device” almost anything at all that is capable of carrying meaning, this language, read literally, is not restrictive. The courts and the United States Patent and Trademark Office (“USPTO”) have authorized for use as a mark package/container shapes (such as that of a Coca-Cola bottle), sounds (such as that of NBC’s three chimes), and even scents (such as the “flowery musk scent” in Verizon stores).”)

<sup>10</sup> See *Fuddruckers, Inc. v. Doc’s B.R. Others, Inc.*, 826 F.2d 837, 841 (9th Cir. 1987) (“we agree with Fuddruckers that a restaurant’s decor, menu, layout and style of service may acquire the source-distinguishing aspects of protectable trade dress such that their imitation is likely to cause consumer confusion.”). See, also, *How to Protect Your Concept Store: Interior Design Under Trademark and Copyright Law, Part 1*, INTA Bulletin (January 15, 2020).

<sup>11</sup> See U.S. Federal Trademark Registration Nos. 4783688 (“The mark consists of three dimensional trade dress configuration depicting the exterior of a retail beverage store front with the theme of an aviation hangar. The storefront has a prominent elevated crescent shaped archway at its top with nine windows placed along the top of the arch and surrounded by horizontal metal panels. To the right and left of the main entrance to the retail store appears a grid of twenty frosted glass rectangles framed in metal below horizontal corrugated metal framing.”), 4948104 (“The mark consists of the design and layout of a retail store...”), and 3956102 (“The mark consists of three-dimensional trade dress for the appearance of a retail bakery shop offering cafe services, produced by a combination of a building with a white exterior, black awnings and significant glass storefront, having visible, through the glass, pink boxes and cupcakes displayed on elevated trays...”).

<sup>12</sup> RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 12 (1995).

of partners in a general partnership). While the definition of trade name does appear to overlap with the definition of a trademark, trade names serve a different purpose. Trade names are most often used in business filings with state and government agencies as opposed to identifying the goods and services offered by that business. Thus, trade names are not source indicators to consumers and therefore are not eligible for trademark protection (unless of course the trade name is also used as a trademark).<sup>13</sup> Trade names, unlike trademarks, often include corporate identifiers such as “Inc.” or “Company” and are found together with physical company addresses and domain names.

### **3. Goodwill**

In their role as a source indicator, trademarks convey a multitude of information to consumers and ultimately become intertwined with the goods and services they identify. As consumers begin to recognize and positively associate a trademark with goods and services, the value – or goodwill – of that trademark increases. For companies with particularly strong trademarks, goodwill can often be the companies’ most valuable asset.<sup>14</sup> The Apple® brand, for instance, was recently valued at \$322,999,000.<sup>15</sup>

### **B. Obtaining Trademark Rights and Protection**

In the United States, trademarks are distinguishable from other forms of intellectual property in that they contain no intrinsic property value. Instead, the acquisition of trademark rights is predicated on the owner’s use of the mark in commerce in connection with the goods or services sold under a given mark, and not as a contribution to society through creation with independent worth, such as with patentable inventions and copyrightable works.<sup>16</sup> Trademarks also differ from other forms of intellectual property in that consumers play a crucial role in dictating when and for how long trademark protection exists as well as its strength. Namely, trademark rights only exist so long as the mark serves a source indicator. If the public ceases to recognize a trademark as a source indicator, then the mark will lose protection.<sup>17</sup>

## **2. Trademarks Must be Distinctive**

To avoid confusion in the marketplace, trademarks must be distinguishable from others – they must be distinct. In order to determine whether a particular mark is distinctive, and thus eligible for trademark protection, courts have developed a

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<sup>13</sup> See Trademark Manual of Examining Procedure (“TMEP”), USPTO, TMEP 1202.01 Refusal of Matter Used Solely as a Trade Name.

<sup>14</sup> See Emily A. Bayton, United States: The Value of Goodwill in Trademarks, available at: <https://www.mondaq.com/unitedstates/Intellectual-Property/698882/The-Value-Of-Goodwill-In-Trademarks>.

<sup>15</sup> See Interbrand’s annual survey of its “Best Global Brands” report (<https://interbrand.com/best-global-brands/apple/>).

<sup>16</sup> See *United Drug Co. v. Theodore Rectanus Co.*, 248 U.S. 90, 97 (1918) (“There is no such thing as property in a trade-mark except as a right appurtenant to an established business or trade in connection with which the mark is employed.”)

<sup>17</sup> See *DuPont Cellophane Co. v. Waxed Prods. Co.*, 85 F.2d. 75, 81 (2d Cir. 1936).

spectrum within which to classify marks.<sup>18</sup> This spectrum of distinctiveness – commonly referred to as the “Abercrombie Spectrum” – classifies words and marks into the following five categories:

2. **Generic:** A “Generic” word refers to or is understood to refer to the genus or class of which a particular product is a species (i.e., CAR for a car).<sup>19</sup> Put more simply, they are words that people use to describe a particular product or service in a general way. Generic words are never eligible for trademark protection because granting such protection would run counter to the goals of trademark law. Competitors need to be able to describe their goods and services using commonly understood words. Allowing someone to obtain trademark protection for a generic word would decrease economic efficiency and impose unnecessary costs on competitors who would need to find a new term to refer to their products and services. Further, granting one party trademark protection for a generic word like “car” would also almost certainly lead to consumer confusion. (Examples include CAR WASH, RESTAURANT, and GROCERY STORE.)
3. **Descriptive:** “Descriptive” marks describe a quality, function, characteristic, or ingredient of a product or service.<sup>20</sup> A classic example of a descriptive mark is “Yellow Pages” for a phone book with yellow-colored pages. Descriptive marks are not inherently distinctive and therefore, are not automatically protectable. (Examples include PARK ‘N FLY, COMPUTERLAND, VISION CENTER, and surnames) However, descriptive marks can acquire distinctiveness (obtain “secondary meaning”) in the eyes of consumers. Secondary meaning refers to distinctiveness that develops through use of the mark over time (typically at least five years), such that consumers begin to assign a secondary source identifying meaning to the mark beyond its common definition and usage. (Descriptive marks that became distinctive include E\*TRADE for electronic trading, THE WEATHER CHANNEL for weather reporting, THE CONTAINER STORE for retail storage, WINDOWS for windowing software, CHAPSTICK for lip balm, AFTERTAN for skin cream, and GENERAL MOTORS for automobiles.)
4. **Suggestive:** A “suggestive” mark is a mark that creates an impression of the goods or services it is used in connection with, and therefore “requires the observer or listener to use imagination and perception to determine the nature of the goods.”<sup>21</sup> Some examples of suggestive marks are DOORDASH for delivery services, YOUTUBE for a streaming service, OPENTABLE for online reservations, GROUPON for discounted services, ROACH MOTEL for insect control, MICROSOFT for software for microcomputers, and NETSCAPE for scanning the

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<sup>18</sup> *Abercrombie & Fitch Co. v. Hunting World*, 537 F.2d 4, 9 (2nd Cir. 1976).

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* at 10.

<sup>21</sup> *Induct-O-Matic Corp. v. Inductotherm Corp.*, 747 F.2d 358, 362 (6th Cir. 1984).

landscape of the Internet. Suggestive marks are deemed inherently distinctive and therefore are protectable without a showing of secondary meaning.<sup>22</sup>

2. *Arbitrary*: “Arbitrary” trademarks are existing words, with dictionary meanings, but do not describe the goods or services they are used in connection with.<sup>23</sup> Well known examples of arbitrary trademarks include GOOGLE for a search engine, APPLE for computers, AMAZON for online shopping, GAP for clothing, TARGET for department stores, and TIDAL for a music company. Arbitrary marks are inherently distinctive and are automatically protectable.<sup>24</sup>
3. *Fanciful*: “Fanciful” trademarks are coined terms that have been “completely fabricated by their owners.”<sup>25</sup> Well known examples of fanciful trademarks include XEROX for copying equipment. CLOROX for bleach, ETSY for an e-commerce site, VERIZON for a phone company, ROLEX for watches, and LEXUS for cars. Fanciful marks are the strongest class of trademark and are inherently distinctive.<sup>26</sup>

## 2. Use in Commerce, Enhanced Rights Through Registration

In the United States, a trademark owner establishes trademark rights simply by being the first to use a distinctive mark in commerce. However, federal registration and, to a lesser extent, state registration, allow owners to bolster those trademark rights.

### a. Common Law Rights

In the United States, common law trademark rights arise through (1) first or prior actual use of; (2) a distinctive trademark; (3) in connection with goods or services; (4) in commerce.

Common law trademark rights are established by the person or entity who is the first to make *bona fide* use in commerce of a trademark in connection with the offer of goods and/or services.<sup>27</sup> However, unlike trademark rights bolstered through federal registration, common law rights are limited to: (1) the geographic area in which the trademark is actually being used in association with the actual goods or services provided, (2) the trademark owner’s zone of actual goodwill (encompassing the area in which the trademark user has established a reputation or business presence), and (3) the trademark owner’s zone of natural expansion.

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<sup>22</sup> *Abercrombie & Fitch Co.*, 537 F.2d 4, 10.

<sup>23</sup> *Moose Creek, Inc. v. Abercrombie & Fitch Co.*, 331 F. Supp. 2d 1214, 1222 (C.D. Cal.).

<sup>24</sup> *Abercrombie & Fitch Co.*, 537 F.2d 4, n. 12.

<sup>25</sup> *Kellogg Co. v. Toucan Golf, Inc.*, 337 F.3d 616, 624 (6th Cir. 2003).

<sup>26</sup> *Abercrombie & Fitch Co.*, 537 F.2d 4, 11.

<sup>27</sup> *Societe de Developments et D'Innovations des Marches Agricoles et Alimentaires-SODIMA-Union de Cooperatives Agricoles v. Int'l Yogurt Co.*, 662 F. Supp. 839, 853 (D. Or. 1987).

“Actual use” can generally be shown when use of a mark goes beyond casual, sporadic, or *de minimis* use.<sup>28</sup> Courts will weigh a number of factors to determine whether actual use in a market exists, such as sales figures, number of customers, and potential growth.<sup>29</sup> However, actual sales are not necessary to establish rights through use in commerce. A business may acquire trademark priority by showing that they have acquired a reputation or business presence in a market, absent any sales.<sup>30</sup> This can be evidenced through pre-sale publicity or advertising, combined with a legitimate intent to continue using the mark.<sup>31</sup> Finally, a business may be able to establish trademark protection in areas contiguous to where they have established actual use or a zone of goodwill.<sup>32</sup> Courts have a number of tests for determining when and where this “zone of natural expansion” exists.<sup>33</sup>

### **b. State Registration**

A trademark owner may also opt to register their mark with one or more states. If a federal registration exists, state registration usually is not necessary; however it does provide a generally less expensive alternative if a mark is only used locally or otherwise is not eligible for federal registration.

A state trademark registration creates benefits under state law by recognizing a trademark owner’s rights within a particular state, and it provides notice to other parties who may seek to use that trademark. State trademark registrations also may provide additional remedies not otherwise available at common law.

### **c. Federal Registration**

To be eligible for a federal registration, a trademark owner must be using the mark in interstate commerce – across state lines. Obtaining a federal registration on the USPTO Principal Register provides several significant benefits, including:

- *Presumption of ownership:* Registration confers a presumption of ownership, validity of the mark, and the exclusive right to use that trademark in connection with the goods and/or services for which it is registered.<sup>34</sup> In the event of a dispute with a third party, this shifts the

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<sup>28</sup> *Id.*

<sup>29</sup> *Charles Jacquin Et Cie, Inc. v. Destileria Serrales, Inc.*, 921 F.2d 467, 473-74 (3d Cir. 1990).

<sup>30</sup> *Popular Bank of Fla. v. Banco Popular de Puerto Rico*, 9 F. Supp. 2d 1347, 1355 (S.D. Fla. 1998) (“A party who has established a reputation in an area may acquire exclusive rights to its mark there, even though the product bearing its mark is not sold in the area”).

<sup>31</sup> *Societe de Developments et D’Innovations des Marches Agricoles et Alimentaires-SODIMA-Union de Cooperatives Agricoles.*, 662 F. Supp. 839, 853.

<sup>32</sup> *Popular Bank of Fla.*, 9 F. Supp. 2d 1347, 1355.

<sup>33</sup> *Id.*

<sup>34</sup> 15 U.S.C. § 1057(b).

burden of proving trademark rights from the registrant to the party challenging the mark.

2. *Incontestability*: Once a trademark has been registered and in use for five years, it becomes eligible to be deemed incontestable (with some limited exceptions). One must file a declaration and pay a fee, it is not automatic. Incontestability is of great value to trademark owners, as it makes it difficult for third parties to challenge ownership of the trademark.<sup>35</sup>
3. *Constructive Notice*: Registration gives constructive notice to all third parties of the owner's rights in the mark. Unlike under common law, if a third party adopts the same or similar trademark without actual knowledge of the registration, they may not use lack of knowledge as a defense to infringement.<sup>36</sup>
4. *Nationwide Priority*: Federal registration expands rights nationwide. However, a registrant may not necessarily enforce its rights nationwide to enjoin use by a junior user who adopted a mark in good faith. Geographic overlap (which can include overlapping internet use) is necessary to show that a likelihood of confusion exists.<sup>37</sup>
5. *Remedies*: Once a trademark is federally registered, a trademark owner may bring trademark infringement actions under the Lanham Act, which provides various remedies for infringement including injunctions, damages, recovery of profits and the destruction of infringing materials.<sup>38</sup>
6. *Right to Use ® Symbol*: The owner of a federal registration may use the ® symbol, which can have a strong deterrent effect on third party possible adopters of similar brands.

In order to obtain a federal trademark registration, the trademark owner must file an application with the USPTO on the basis of (1) the actual use of a trademark; (2) a bona fide intention to use the mark in commerce; (3) a foreign application or registration; or (4) a combination of (1)-(3).<sup>39</sup> The entire application or prosecution process will take anywhere from nine to 18 months, and generally follows the steps outlined below:

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<sup>35</sup> 15 U.S.C. § 1065.

<sup>36</sup> 15 U.S.C. § 1072.

<sup>37</sup> Known as the "Dawn Donuts Rule", the owner of a federal registration, theoretically conferring nationwide rights, might not be entitled to an injunction against a user of an infringing mark in a geographic region if the junior user can show that there is no actual overlap because a likelihood of confusion cannot be shown. See *Dawn Donut Co. v. Hart's Food Stores, Inc.*, 267 F.2d 358 (2d Cir. 1959); see also, *Guthrie Healthcare System v. ContextMedia, Inc.*, 826 F.3d 27 (2d Cir. 2016).

<sup>38</sup> 15 U.S.C. § 1051; 15 U.S.C. § 1114.

<sup>39</sup> 15 U.S.C. § 1051.

2. Within three to four months after filing the application, the USPTO will assign the application to an examiner who will determine whether the application meets the statutory requirements, and thus whether the mark is entitled to registration.<sup>40</sup> More specifically, the examiner will review the application to determine: (1) whether the selected trademark has the requisite distinctiveness to serve as a source identifier (see discussion above); (2) whether the selected mark is confusingly similar to another mark that is already registered or pending registration<sup>41</sup>, and (3) whether mechanical aspects of the application have been properly prepared.<sup>42</sup> A trademark application may be rejected for a variety of other reasons as well, such as if the USPTO examiner determines the mark is immoral, deceptive, or scandalous.<sup>43, 44</sup>
3. If the USPTO examiner determines that any aspect of the application falls short of the requirements for registration, the examiner will issue an "Office Action."<sup>45</sup> An Office Action is a written communication that sets forth the objections or issues the examiner identifies with the mark or the application.<sup>46</sup> The applicant must respond to the Office Action within the stated time (typically six months) in order to avoid abandonment of the application.<sup>47</sup> The amount of time it takes to overcome an Office Action will depend upon the situation. A technical objection (such as disclaiming a descriptive term, or re-wording the description of goods or services) may be processed quickly. A substantive refusal such as the examiner determining that the mark is generic or descriptive, or the examiner finding that the mark is confusingly similar to a prior pending or registered mark, requires submission of evidence and argument to create a record for potential appeal. An applicant may be able to successfully overcome the objections through a written response to the Office Action, or by communicating with the examiner and approving an examiner's amendment to the application. Or, the applicant may seek a solution in the marketplace – such as negotiating a co-existence agreement with the owner of the cited mark.
4. If and when the USPTO's examiner finds that the mark is eligible for registration, the USPTO will publish the mark in the *Official Gazette* to

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<sup>40</sup> 15 U.S.C. § 1052.

<sup>41</sup> TMEP 12.07 Likelihood of Confusion, (<https://tmep.uspto.gov/RDMS/TMEP/current#/current/TMEP-1200d1e5044.html>). *In re E. I. du Pont de Nemours & Co.*, 476 F.2d 1357, 177 USPQ 563 (C.C.P.A. 1973) (seminal case involving likelihood of confusion under § 2(d), the US Court of Customs and Patent Appeals discussed the factors relevant to a determination of likelihood of confusion).

<sup>42</sup> *Id.*

<sup>43</sup> 15 U.S.C. § 1052(a).

<sup>44</sup> *In re McGinley*, 660 F.2d 481, 486 (C.C.P.A. 1981) (mark comprising a photograph of a nude, reclining man and woman, kissing and embracing, for a "newsletter devoted to social and interpersonal relationship topics" and for "social club services" held to be scandalous).

<sup>45</sup> 15 U.S.C. § 1062(b).

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

notify others of the pending registration.<sup>48</sup> A registrant of a conflicting mark (or any other party that has a valid basis for objecting to registration) has 30 days to file a notice of opposition to the application.<sup>49</sup> Upon request, the USPTO can extend this opposition period for additional 30-day periods not to exceed 180 days.<sup>50</sup> If no one opposes the mark in this period, the USPTO will issue a Certificate of Registration for marks that are in use or a Notice of Allowance for “intent to use” applications.<sup>51</sup>

- Once the mark is registered, any senior trademark owners have five years to petition the Trademark Trial and Appeal Board (“TTAB”) to cancel the mark’s registration.<sup>52</sup> Further, between the fifth and sixth years after registration, the trademark owner must file a Declaration of Use to maintain the registration or the mark will automatically be canceled.<sup>53</sup> If eligible, the registrant can file a combined Declaration of Use and Incontestability.
- Assuming that the mark is not cancelled by the TTAB or otherwise abandoned, and the mark owner makes the requisite declaration, the registration on the Principal Register will become incontestable after five years.<sup>54</sup> As discussed above, once a mark becomes incontestable it becomes very difficult for a third party to successfully bring an infringement claim.
- A U.S. trademark registration is valid for a period of 10 years. A trademark owner may renew its registration between the ninth and tenth years after the original registration issued, and every 10 years thereafter.

#### **d. USPTO Supplemental Register**

If the USPTO examiner finds that a mark is not eligible for registration on the Principal Register because it is descriptive (lacks distinctiveness), a mark owner may nonetheless opt to register the mark on the USPTO’s “Supplemental Register.”<sup>55</sup> The Supplemental Register is for descriptive marks that have not yet acquired secondary meaning. While the Supplemental Register confers fewer rights than registration on the Principal Register, such registration does allow the owner to use the federal registration symbol, ®, and can block applications for similar marks that are filed later.<sup>56</sup>

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<sup>48</sup> 15 U.S.C. § 1062(a).

<sup>49</sup> 15 U.S.C. § 1063(a).

<sup>50</sup> 37 CFR § 2.102.

<sup>51</sup> 15 U.S.C. § 1063(a).

<sup>52</sup> 15 U.S.C. § 1064(1).

<sup>53</sup> *Id.* §§ 1065, 1058.

<sup>54</sup> *Id.*

<sup>55</sup> 15 U.S.C. § 1091.

<sup>56</sup> See INTA Bulletin, *The U.S. Trademark Registers: Supplemental vs. Principal* (May 1, 2012).

If the mark acquires secondary meaning at any point after registration on the Supplemental Register, the owner may submit a new application for registration on the Principal Register. Typically, five years of consistent use of a mark capable of acquiring distinctiveness will provide the presumption of acquired distinctiveness; however, further evidence is sometimes required.<sup>57</sup>

#### **e. International Trademark Protection**

Trademark rights are geographically and jurisdictionally limited (unless a mark is so strong and well-known that it gains additional protection through the Paris Convention). Thus, outside the U.S., rights in a mark are acquired by country or region (where there is a regional registration scheme, such as the European Union or the Organisation Africaine de la Propriete Intellectuelle, known as OAPI) as dictated by the applicable law.

Depending upon the country or region, trademark rights can be acquired by the first to use a mark (as in the U.S., Canada, and Australia) or by the first to file an application that matures into a registration. This means that in some circumstances a third party can acquire legitimate trademark rights in a country to which your franchise system seeks to expand.

### **3. How to Identify, Clear, Register, and Maintain a Trademark**

There are four basic steps in obtaining and retaining trademark protection: (1) selecting a mark; (2) checking availability of the mark; (3) registering the mark; and (4) managing the mark, i.e. correctly using the mark, maintaining the registration, and enforcing the owner's rights in the mark. As discussed above, the strength of a trademark can vary substantially from weak, descriptive marks, to strong, arbitrary or fanciful marks. Putting aside issues of eligibility for trademark protection, the Abercrombie Spectrum serves as a useful guide for selecting a trademark.

Franchisors can select their own marks or engage a third party, like a branding company. It is not uncommon for a company to lean instinctively towards a mark that is weak and descriptive due to a worry that the public will not know what the company does if the name is too creative. There are times when selecting a mark that is not inherently distinctive is a reasonable business decision. Taglines also can be used together with distinctive marks with the tagline serving as the "informative" element. For example, Verizon's CAN YOU HEAR ME NOW? GOOD. and Carvel's AMERICA'S FRESHEST ICE CREAM slogans educate the consumer about the products offered by the brand.

Federal trademark law is designed to protect rights in distinctive marks and avoid confusion in the marketplace as to the source, origin, sponsorship, or affiliation of the goods or services associated with those marks. The legal standard, used by both the USPTO in reviewing applications for registration of trademarks and courts in deciding suits for trademark infringement is "likelihood of confusion." While there are a variety of factors employed in comparing

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<sup>57</sup> 15 U.S.C. § 1052(f).

competing marks, the similarity of the marks and the similarity of the goods or services are the two key factors. Similarity of the marks includes the appearance, sound, connotation, and commercial impression created. Therefore, selecting a mark that avoids confusion with another user's mark should be a key focus when evaluating a proposed mark.

When selecting a new mark, a franchisor or its attorney often begins by conducting a general search online (e.g. Google search) to see if there are any obvious competing or uses with undesirable affiliations (e.g. a disreputable site). A next step is to conduct a screening search of the online records of the USPTO ([www.uspto.gov](http://www.uspto.gov)) to determine whether an identical or similar mark has already been applied for or registered by another user for the same or related goods and services. The USPTO (as well as many trademark offices outside the U.S.) uses the International Classification system that categorizes goods and services into 45 different classes.<sup>58</sup>

Thus, if a restaurant company is interested in using the mark TAMA for a sandwich, it will be interested in discovering whether another user has registered the mark TAMA in class 30 (which includes certain food products such as sandwiches) or class 43 (which includes a variety of services including restaurant services). The fact that another party has registered the mark TAMA in class 15 for drums is unlikely to prevent the use and registration of TAMA for a sandwich. Drums and sandwiches are not typically related nor offered by the same types of retail outlets and thus consumers are not likely to be confused by use of the same mark.<sup>59</sup>

If the screening search finds that there are no obvious bars to registration at the USPTO, a franchisor or its counsel should perform additional more thorough searches over the Internet and through domain name registries to determine if there are any other prior users of the mark that may not have sought federal trademark registration. The standard in the industry prior to adopting a mark for use on the national level is to obtain a full US availability clearance search from vendors such as Corsearch or Compumark. These professional search companies conduct comprehensive searches that identify registered and pending marks at the federal and state level as well as marks with common law rights. These searches include state and federal trademark databases as well as business listings, journals, industrial indexes, company names, domain names, web pages, and yellow and white page listings among many others. These services identify not only identical (and phonetically equivalent) marks but also marks that are similar to the proposed mark. The time and expense in clearing a proposed mark is money well spent, considering the negative ramifications of developing a product or a service offering and discovering later that the mark conflicts with the trademark rights of a prior user. A prior user, whether discovered or not by even the most thorough search, has priority and can prevent confusingly

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<sup>58</sup> TMEP 1401 Classification (<https://tmep.uspto.gov/RDMS/TMEP/current#/current/TMEP-1400d1e1.html>).

<sup>59</sup> INTA Bulletin, *Branding the Sandwich: Establishing Trademarks in Restaurant Menu Items*, Valerie Brennan (March 15, 2009).

similar uses by a later diligent user.<sup>60</sup>

One common obstacle business owners who are considering franchising face is discovering that another business owner is using the same or a similar trademark or trade name for a similar type of business in a geographically remote area. For example, if there is a TURTLES ice cream shop in the Southeast and a TURTLES ice cream shop in the Northeast, which business has the right to use the mark and to obtain a federal trademark registration? In the United States, priority is given to the first TURTLES business that used the mark in interstate commerce. This is true even if the second user of the mark was the first business to file an application to register the mark with the USPTO. Accordingly, prior to franchising, even if a business owner has already started using a mark, they should conduct a trademark clearance search to determine whether anyone else is concurrently using the same or a similar mark for similar goods and services. And, if so, the business owner will need to determine who has priority as the first interstate user of the mark. If a prior user exists, then the business owner should consider adopting a new mark to represent its goods or services or explore purchasing the mark from the prior user.

#### **4. Trademark Infringement Claims**

Because trademarks are often the lifeblood of a franchise system, trademark infringement claims are among the most common, and most important, claims asserted in the franchise context. It is critical for a franchisor to protect the strength and value of its trademarks in order to protect its brand. That in turn allows the franchisor and its franchisees to identify themselves and differentiate themselves from competitors. Maintaining a strong brand reinforces the association between the franchisor's trademarks and its quality products and services. Trademark infringement claims can arise in a variety of contexts, such as when a franchisee continues to use the franchisor's trademarks following expiration or termination of the franchise agreement, where the franchisee transfers its franchise to a third party without authorization, where a franchisee exceeds the scope of its authorization to use the franchisor's trademark under the franchise agreement, or where an unaffiliated third party infringes the franchisor's trademarks. Trademark and unfair competition laws provide an important tool for franchisors to protect their trademarks from infringement and other misuse.

Trademarks are primarily protected from infringement by federal law, but certain states also provide common law and statutory remedies for trademark infringement and unfair competition. Under federal law, the Lanham Act provides strong protection for franchisors' registered and unregistered trademarks.<sup>61</sup> Among other things, the Lanham Act prohibits the use, without consent from the trademark owner, of any registered trademark in commerce in a manner that "is

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<sup>60</sup> See *Dawn Donut Co. v. Hart's Food Stores, Inc.*, 267 F.2d 358 (2d Cir. 1959).

<sup>61</sup> See Lanham Act, 15 U.S.C. § 1051, *et seq.* The Lanham Act also creates a claim for trade dress infringement when the trade owner can show that the defendants' use of its trade dress is likely to confuse consumers as to the source of the defendants' products and services. See *Two Pesos, Inc. v. Taco Cabana, Inc.*, 505 U.S. 763, 769-70 (1992).

likely to cause confusion, or to cause mistake, or to deceive” the public.<sup>62</sup> The Lanham Act also prohibits the use in commerce of “any false designation of origin, false or misleading description of fact, or false or misleading representation of fact,” which “is likely to cause confusion, or to cause mistake, or to deceive” as to the origin of the goods or services.<sup>63</sup>

A trademark owner (senior user, first to use a mark) may bring a trademark infringement claim against a junior user (later adopter of a mark) of a “confusingly similar” mark. Whether a mark is confusingly similar is a question of fact based upon different factors depending upon which federal circuit a case is brought before.<sup>64</sup> The 9<sup>th</sup> Circuit considers the following factors: (1) the similarity of the overall impression of the marks, encompassing their look, sound, or meaning; (2) the similarity of the underlying goods and services; (3) the strength or weakness of the plaintiff’s mark (that is, the distinctiveness of plaintiff’s mark); (4) any evidence of actual confusion by consumers; (5) the defendant’s intent in adopting the mark; (6) the proximity of goods in the retail marketplace (such a similarity of trade channels or overlap of customers); (7) the degree of care exercised by the consumer (for example, are the consumers sophisticated or are the purchases impulse buys); and (8) the likelihood of expanding the lines of goods and services.<sup>65</sup>

Section 43(c) of The Lanham Act (15 U.S.C. § 1125(c)) provides for additional relief for the owners of “famous” trademarks. That provision establishes an independent claim for trademark dilution, pursuant to which owners of a famous mark can obtain injunctive relief against use of another trademark or trade name that commences after the owner’s mark has become famous and “that is likely to cause dilution by blurring or dilution by tarnishment of the famous mark.” Depending upon the trademark and the nature of the conduct at issue, franchisors have multiple potential remedies at their disposal to protect their trademarks.

The touchstone of a trademark infringement claim is “likelihood of confusion” among consumers caused by the misuse of the franchisor’s trademark.<sup>66</sup> The likelihood of confusion analysis is usually very fact specific, sometimes making it difficult to predict how a court will decide a case. While the Lanham Act requires only a showing of likelihood of confusion, evidence of actual

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<sup>62</sup> 15 U.S.C. § 1114(1) (protecting registered trademarks).

<sup>63</sup> 15 U.S.C. § 1125(a) (protecting both registered and unregistered trademarks).

<sup>64</sup> First Circuit 8 Factors (*Pignons S. A. de Mecanique de Precision v. Polaroid Corp.*, 657 F.2d 482, 487 (1st Cir. 1981); Second Circuit 8 Factors (*Polaroid Corp. v. Polarad Electronics Corp.*, 287 F.2d 492, 495 (2d Cir. 1961); Third Circuit 10 Factors (*Interpace Corp. v. Lapp, Inc.*, 721 F.2d 460, 463 (3d Cir. 1983); Fourth Circuit 11 Factors (*Pizzeria Uno Corp. v. Temple*, 747 F.2d 1522, 1527 (4th Cir. 1984); Fifth Circuit 7 Factors (*Roto-Rooter Corp. v. O’Neal*, 513 F.2d 44, 45 (5th Cir. 1975); Sixth Circuit 8 Factors (*Frisch’s Restaurant, Inc. v. Shoney’s Inc.*, 759 F.2d 1261, 1264 (6th Cir. 1985); Seventh Circuit 7 Factors (*Helene Curtis Indus., Inc. v. Church & Dwight Co.*, 560 F.2d 1325 (7th Cir. 1977); Eighth Circuit 6 Factors (*Helene Curtis Indus., Inc. v. Church & Dwight Co.*, 560 F.2d 1325 (7th Cir. 1977); Ninth Circuit 8 Factors (*AMF Inc. v. Sleekcraft Boats*, 599 F.2d 341, 348–49 (9th Cir. 1979)); Tenth Circuit 6 Factors (*Universal Money Centers, Inc. v. AT&T Co.*, 22 F.3d 1527, 1530 (10th Cir. 1994) Eleventh Circuit 7 Factors (*Wesco Mfg., Inc. v. Tropical Attractions of Palm Beach, Inc.*, 833 F.2d 1484, 1488 (11th Cir. 1987); Federal Circuit and the USPTO The 13 DuPont Factors *In re E.I. du Pont de Nemours & Co.*, 476 F.2d 1357, 1361, (C.C.P.A. 1973).

<sup>65</sup> *AMF Inc. v. Sleekcraft Boats*, 599 F.2d 341, 348–49 (9th Cir. 1979).

<sup>66</sup> 15 U.S.C. §§ 1114(1), 1125(a).

customer confusion is even more persuasive, as it reduces the need for courts to speculate about the theoretical likelihood of confusion. In litigation, a franchisor's burden of showing likelihood of confusion can be lower with respect to terminated hold-over franchisees who continue to use the franchisor's trademarks in the same location because courts sometimes presume a likelihood of confusion in that context.<sup>67</sup> Franchisors can use a wide range of evidence to prove customer confusion, including expert testimony, visual comparisons of trademarks, presenting live testimony or affidavits from customers as to their confusion, and relying on customer complaints or surveys that demonstrate confusion.<sup>68</sup> In addition to evidence of actual confusion, courts often consider a variety of other factors in analyzing whether use of a trademark is likely to cause customer confusion, including the strength or distinctiveness of the plaintiff's trademark, the similarity of the two marks, the similarity of the goods and services at issue, the similarity of the parties' respective advertising utilizing the marks, and the defendant's intent.<sup>69</sup>

Because franchisors asserting trademark infringement claims often seek injunctive relief, another critical factor is whether the franchisor can establish the likelihood of irreparable harm flowing from the infringement. The Trademark Modernization Act of 2020<sup>70</sup> ("TMA") provides that a trademark owner seeking injunctive relief is entitled to a rebuttable presumption of irreparable harm upon a finding of infringement or a likelihood of success on the merits. This uniform rule resolved a split in the Circuits and will help trademark owners enforce their rights against infringers in federal court.

Common defenses to trademark infringement claims can include, but are not limited to, the assertion that the owner abandoned the trademark at issue or that the alleged use is fair use. "Fair use" occurs where the alleged infringer has used another's mark as a descriptive term and "nominative fair use" is where an alleged infringer has used another's mark to make a statement about the other's product or service (such as in comparative advertising). Another defense is that the mark has become generic. Equitable defenses such as laches (an unreasonable delay in enforcing trademark rights that causes prejudice to the alleged infringer) and acquiescence (implied or actual consent to the alleged infringer's use of the mark) may also be available. 15 U.S.C. § 1115(b) contains a list of defenses that would invalidate the plaintiff's rights in the claimed trademark

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<sup>67</sup> *Burger King v. Mason*, 710 F.2d 1480, 1492 (11th Cir. 1983) ("Common sense compels the conclusion that a strong risk of consumer confusion arises when a terminated franchisee continues to use the former franchisor's trademarks.").

<sup>68</sup> Defendants may object to the franchisor's reliance on out-of-court statements, such as customer surveys, as hearsay. Certain courts have, however, allowed such evidence to be admitted, either concluding that such statements are not hearsay or allowing the admission of the statements under exceptions to the hearsay rule. See, e.g., *HLT Existing Franchise Holding, LLC v. Worcester Hospitality Group, LLC*, 994 F. Supp. 2d 520, 535 (S.D.N.Y. 2014) (considering guest satisfaction surveys because they were not admitted to prove the truth of the matter asserted in the statement, but rather solely to prove what the guests reported to the hotel), *aff'd* by 609 Fed. Appx. 669 (2d Cir. 2015); *Schering Corp. v. Pfizer Inc.*, 189 F.3d 218, 226-28 (2d Cir. 1999) (surveys can be admissible in Lanham Act cases to establish customer confusion because they report customers' present-sense impressions).

<sup>69</sup> *Synergist Intl, LLC v. Korman*, 470 F.3d 162, 170 (4th Cir. 2006).

<sup>70</sup> The TMA amends Section 34 of the Trademark Act of 1946 (15 U.S.C. § 1116) to provide for the presumption of irreparable harm in trademark actions.

registration.

A successful trademark infringement plaintiff can obtain injunctive relief, including an order that the infringing conduct be stopped.<sup>71</sup> The trademark owner may also be able to recover monetary damages. Under the Lanham Act, an infringing defendant may be ordered to pay the trademark owner's actual damages or treble damages in extreme cases; it may be required to disgorge its profits or pay the costs of the action. In exceptional cases, the court may award reasonable attorneys' fees to the prevailing party.<sup>72</sup> Punitive damages are not available under the Lanham Act, although punitive damages may be available under certain states' laws if the infringement is willful. Courts may also order other relief, such as seizure and destruction of infringing goods. Except in certain cases, only injunctive relief is available to a trademark holder prevailing on a trademark dilution claim.

## 5. Best Practices for Managing Trademarks

Properly managing a mark is essential to preserving rights. This includes using a trademark notice, making appropriate use of the mark, and enforcing a trademark owner's rights.

A trademark notice informs others that the owner is claiming rights in the trademark and discourages others from adopting a similar or infringing mark. Trademark notice is not mandatory, however, when an owner can assert that the notice routinely appears with the mark, it is good evidence that a junior user may not be acting innocently. For common law marks, the TM notice is appropriate.<sup>73</sup> For trademarks registered with the USPTO, the "®" symbol is the most commonly used.<sup>74</sup>

The ® notice may not be used unless the USPTO has issued a certificate of registration for the mark. If the owner of a federally registered mark fails to use a trademark notice, no profits or damages may be awarded in a trademark infringement case unless the defendant had actual notice of the registration.<sup>75</sup>

There is no uniformity concerning use of marking symbols abroad. While many countries have specific symbol requirements, many have no marking requirements at all.

Properly using a mark in commerce also helps reinforce trademark owners' rights. Some practical tips include:

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<sup>71</sup> 15 U.S.C. § 1116(a).

<sup>72</sup> *Id.* at § 1117(a).

<sup>73</sup> Some owners use the "SM" notice for service marks.

<sup>74</sup> See 15 U.S.C. § 1111. "Registered in U.S. Patent and Trademark Office" and "Reg. U.S. Pat. & Tm. Off." are less common but also acceptable for federally registered marks.

<sup>75</sup> See *Id.*

- Use trademarks as adjectives and never as nouns or verbs. To this end, avoid:
  - making a mark plural by adding “s”. Rather, make the common or generic word after the mark plural (NIKE sneakers, not NIKES).
  - adding endings or punctuation to the mark such as “ing” or “ed” (conducted a GOOGLE search, not GOOGLED the term).
- Display a mark consistently (e.g., in the same font, style, and color) to reinforce (and so as not to self-dilute) recognition by consumers. This is especially necessary if the registration is for a stylized version of the mark.
- Make the mark stand out from surrounding text (such as through use of capital letters, bold print, color, or italics).
- Provide regular training on trademark basics and proper use to the company’s internal teams, such as the marketing, communications, or training departments. Doing so is critical to protecting the marks and can help speed the legal review of the materials created by these teams. Additionally, training on intellectual property rights is important to ensure that employees don’t inadvertently infringe upon the rights of others and that they understand the process and timing for conducting trademark searches whether it is for routine advertising and sales materials or for the roll out of a new mark, big promotional campaign or re-branding effort. Encourage all employees to become brand ambassadors and watch for proper use of the franchisor’s brand, and notify management of any potential improper or infringing use by others.

A mark whose use is ubiquitous risks becoming generic for the good or service it is associated with. Former trademarks that are now generic include Aspirin, Escalator, Teleprompter, Linoleum, Laundromat, and Cellophane. To avoid this, use a common descriptor or generic word after the trademark to prevent it from becoming the generic word for the product or service. In some cases, trademark owners follow the mark with “brand” to reinforce the trademark nature, such as LEVI’S brand jeans.

Finally, trademark owners need to enforce their trademark rights in order to protect them. Knowingly allowing others to use infringing marks diminishes the strength of a mark and risks the loss of rights. This does not mean that the owner needs to file lawsuits against every potential infringer. However, trademark owners should make a rational business decision based upon the facts and risks. Responses can range from sending demand letters to challenging applications at the USPTO, filing cancellation proceedings at the USPTO, or pursuing federal trademark infringement lawsuits.

## II. TRADE SECRETS

Much of the value inherent in franchising is made up of trade secrets, the importance of which may equal that of the licensed trademarks. From secret recipes and customer lists to business methods and product development plans, trade secrets are integral parts of the effective business practices and revenue-generating products and services that attract franchisees and propel franchise systems.

Trade secrets are an increasingly prominent focal point for businesses and policymakers worldwide, and their ubiquity in franchise systems makes basic knowledge of trade secret protections essential for franchise attorneys. This section will: (1) define the elements of a trade secret and misappropriation thereof; (2) describe the protections available to trade secret owners under federal, state, and international law; and (3) examine best practices for the use of trade secrets in franchising.

### A. Basic Concepts

#### 1. Elements of a Trade Secret

Trade secrets encompass “all forms and types of...information,...whether tangible or intangible, and whether or how stored, compiled, or memorialized...” so long as: (1) its owner has taken reasonable measures of secrecy; and (2) it derives actual or potential independent economic value from being kept secret.<sup>76</sup> In the franchise context, courts have recognized myriad types of trade secrets, including:

- Business methods<sup>77</sup>
- Development strategies<sup>78</sup>
- Recipes<sup>79</sup>
- Formulas<sup>80</sup>
- Customer lists<sup>81</sup>
- Supply chain information<sup>82</sup>
- New product plans<sup>83</sup>

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<sup>76</sup> 18 U.S.C. § 1839(3).

<sup>77</sup> *Tan-Line Studios, Inc. v. Bradley*, No. 84–5925, 1986 WL 3764, at \*7 (E.D. Pa. March 25, 1986) (holding that the franchisor’s “entire methodology for conducting a tanning studio” constituted a trade secret).

<sup>78</sup> *Motor City Bagels, LLC v. The American Bagel Co.*, 50 F. Supp. 2d 460, 479 (D. Md. 1999).

<sup>79</sup> *KFC Corp. v. Marion-Kay Co.*, 620 F. Supp. 1160, 1172 (S.D. Ind. 1985) (holding that KFC’s secret spice blend constituted a trade secret upon which the “desirability of the franchise itself” depended); *but see Buffets, Inc. v. Klinke*, 73 F. 3d 965, 968-69 (9th Cir. 1996) (finding that Buffets, Inc.’s recipes lacked “the requisite novelty and economic value for trade secret protection”).

<sup>80</sup> *Coca-Cola Bottling Co. v. Coca-Cola Co.*, 107 F.R.D. 288, 294 (D. Del. 1985).

<sup>81</sup> *Am. Express Fin. Advisors, Inc. v. Yantis*, 358 F. Supp. 2d 818 (N.D. Iowa 2005).

<sup>82</sup> *Proimos v. Fair Auto. Repair, Inc.*, 808 F.2d 1273, 1276 (7th Cir. 1987) (holding that even where supplier identities were publicly available, information on the reliability and dealing terms of those suppliers made supplier lists trade secrets).

<sup>83</sup> *See Static Control Components, Inc. v. Darkprint Imaging, Inc.*, 135 F. Supp. 2d. 722, 727–28 (M.D.N.C. 2001).

- Software and technology<sup>84</sup>
- Marketing plans<sup>85</sup>
- Prospective franchisee lists<sup>86</sup>

Unlike patents and copyrights, which have a fixed length, trade secrets are entitled to protection so long as they are kept secret.

## 2. Misappropriation of Trade Secrets

Trade secret misappropriation occurs when trade secrets are acquired, disclosed, or used by persons who knew or had reason to know that such acquisition, disclosure, or use involved “improper means.”<sup>87</sup> The scope of “improper means” exceeds that of mere illegality and encompasses:

- Theft;
- Bribery;
- Misrepresentation;
- Breach or inducement of a breach to maintain secrecy; and
- Espionage.<sup>88</sup>

Trade secret designation does not, however, preclude competitors from obtaining secret information through competitive practices that fall outside the bounds of what constitutes misappropriation, including:

- Independent investigation;
- Reverse-engineering (provided acquisition for such purpose is lawful);
- Discovery under license;
- Public observation; and
- Review of published literature.<sup>89</sup>

Misappropriation of trade secrets is designated to varying degrees as a private civil cause of action, a target for public civil enforcement, and a criminal offense under state, federal, and international law.

## B. Trade Secret Protection

### 1. Federal

Prior to the passage of the federal Defend Trade Secrets Act (“DTSA”) in 2016,<sup>90</sup> trade secret protection was primarily a matter of state law. The DTSA amended the existing Economic Espionage Act of 1996 (“EEA”), which provided

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<sup>84</sup> See *NaturaLawn of America, Inc. v. West Group, LLC*, 484 F. Supp. 2d 392, 399 (D. Md. 2007).

<sup>85</sup> See *H&R Block Eastern Tax Services, Inc. v. Enchura*, 122 F. Supp. 2d 1067, 1074 (W.D. Mo. 2000).

<sup>86</sup> See *Re/Max of Am. v. Viehweg*, 619 F.Supp. 621, 626 (E.D. Mo. 1985).

<sup>87</sup> 18 U.S.C.S. § 1839 (5)–(6).

<sup>88</sup> *Id.*

<sup>89</sup> Uniform Trade Secrets Act § 1(1) cmt., Nat’l Conference of Comms. on Uniform State Laws (1985).

<sup>90</sup> 18 U.S.C. §§ 1831-1839, 1961.

only for criminal penalties.<sup>91</sup> Prosecutions under the EEA were infrequent and the statute was broadly regarded as ineffective.<sup>92</sup>

The DTSA, which became effective in May 2016, serves as an important additional tool for trade secret owners to protect their trade secrets. The DTSA provides a federal private cause of action for trade secret misappropriation.<sup>93</sup> It also expressly provides federal subject matter jurisdiction, which permits trade secret claims to be brought in federal court.<sup>94</sup>

A franchisor's confidential information that rises to the level of a trade secret can be subject to heightened protection, regardless of the presence of a contractual non-disclosure provision. The key threshold issue is often a determination of whether the information at issue qualifies as a trade secret.

The DTSA defines "trade secret" as follows:

All forms and types of financial, business, scientific, technical, economic, or engineering information, including patterns, plans, compilations, programs, devices, formulas, designs, prototypes, methods, techniques, processes, or codes, whether tangible or intangible, and whether or how stored, compiled, or memorialized physically, electronically, graphically, photographically, or in writing if – (A) the owner thereof has taken reasonable measures to keep such information secret and (B) the information derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable through proper means by, another person who can obtain economic value from the disclosure or use of the information.<sup>95</sup>

There are three key components under the DTSA's trade secret definition. First, it must be kept secret. Second, the information must derive independent economic value from not being generally known. Third, the information must not be readily ascertainable through proper means.

Misappropriation is defined as "acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means" or "disclosure or use of a trade secret of another person" obtained through improper means."<sup>96</sup> Under the DTSA, improper means is defined as "includ[ing] theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, or espionage through electronic or other means" and to expressly "not include reverse engineering, independent derivation, or any other

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<sup>91</sup> 104th Congress, P.L. 104-294 (Oct. 11, 1996).

<sup>92</sup> See John R. Thomas, Cong. Research Serv., R41391, *The Role Of Trade Secrets In Innovation Policy* (2014).

<sup>93</sup> 18 U.S.C. § 1836(b)(1).

<sup>94</sup> 18 U.S.C. § 1836(c).

<sup>95</sup> 18 U.S.C. § 1839(3).

<sup>96</sup> 18 U.S.C. § 1839(5).

lawful means of acquisition.”<sup>97</sup>

The DTSA expressly authorizes injunctive relief “to prevent any actual or threatened misappropriation.”<sup>98</sup> It also authorizes monetary damages for the trade secret owner’s actual losses and, depending upon the circumstances, unjust enrichment and/or a reasonable royalty. Treble damages and attorneys’ fees are available under the DTSA based upon the defendant’s willful or bad faith conduct. In limited circumstances, the DTSA authorizes *ex parte* seizure to prevent improper disclosure of trade secrets. The DTSA also provides for civil enforcement by the US Attorney General, and includes an anti-retaliation provision to protect whistleblowers.

Franchisors seeking to enforce trade secret rights in litigation, whether under the federal DTSA or the state statutes discussed below, need to consider several issues. First, franchisors should consider whether the information in question, even if confidential and proprietary, rises to the level of a trade secret. The existence of a trade secret is generally a question of fact. Including contractual acknowledgements in the franchise agreement as to the existence and identification of the franchisor’s trade secrets and limiting the franchisee’s access to those trade secrets can be helpful, but generally will not be dispositive. Information generally loses trade secret protection if it enters the public domain or becomes generally known in the industry.

In order to establish the existence of a trade secret, a franchisor also needs to be prepared to satisfy certain additional requirements, including that the franchisor has taken reasonable efforts to maintain the secrecy of the information and that the information derives independent value from its secrecy. For this reason, franchisors seeking to preserve the trade secret status of certain information about their franchise system or business methods, such as operational materials, training manuals, or recipes, should take affirmative steps to protect the confidentiality of those materials. These steps should include requiring anyone with access to trade secrets to sign a non-disclosure agreement, and may include pre-packing spices and other elements of recipes to limit access to the key ingredients. Franchisors should also be diligent in requiring franchisees and their employees to return proprietary materials upon the end of the franchise relationship. Additionally, franchisors should consider what policies and are in place and how best to ensure that their security systems are being followed.

Another important issue trade secret litigants need to consider is how to balance the need to specifically identify the trade secret and misappropriation at issue in order to satisfy initial pleading standards and ultimately prove misappropriation, with the need to maintain the secrecy of the trade secret itself. This issue has been the subject of judicial debate.<sup>99</sup> Finally, franchisors should consider whether they have direct evidence of misappropriation or merely

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<sup>97</sup> 18 U.S.C. § 1839(6)(A), (B).

<sup>98</sup> 18 U.S.C. § 1836(b)(3)(A)(i).

<sup>99</sup> See, e.g., *Derubeis v. Witten Techs, Inc.*, 244 F.R.D. 676 (N.D. Ga. 2007) (surveying different approaches); *TE Connectivity Networks Inc. v. All Sys. Broadband Inc.*, Civil No. 13-1356 ADM/FLN, 2013 WL 6827348 (D. Minn. Dec. 26, 2013).

circumstantial evidence, and whether that impacts their ability to sustain a valid claim under the applicable law.<sup>100</sup>

## 2. State

State trade secret protection statutes are primarily modeled on the Uniform Trade Secrets Act (“UTSA”), a collaborative model statute created by the National Conference of Commissioners on Uniform State Laws and recommended for enactment by states in 1985.<sup>101</sup> Forty-nine of the fifty states have adopted the UTSA in some form or another. In New York, the last holdout state, a bill to do so was introduced in 2023.<sup>102</sup>

The UTSA defines trade secret and misappropriation, and provides for civil remedies for misappropriation, including injunctive relief for any actual or threatened misappropriation of trade secrets, compensatory damages in the amount of the actual loss caused by misappropriation and the unjust enrichment of the misappropriating party, double damages in cases of willful and malicious misappropriation, and potential attorneys’ fees.<sup>103</sup> If the misappropriating party obtains an economic windfall based upon misappropriated trade secrets, an action under the UTSA will generally require that party to disgorge its profits.<sup>104</sup> Finally, about half of the states have criminal penalties for misappropriation of trade secrets, generally equating the act with theft and conspiracy.<sup>105</sup>

As written, the UTSA displaces conflicting tort law and certain other state civil law related to the protection of trade secrets, but does not impact civil contract law, civil remedies unrelated to trade secrets, or any criminal law.<sup>106</sup>

Despite its goal to standardize state trade secrets law, the UTSA is only a guideline for adopting states, which are free to amend the statute.<sup>107</sup> Common law and the Restatements of Torts and Unfair Competition also have significant role in courts across the nation. The Restatement of Torts sets forth a particularly widely

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<sup>100</sup> See, e.g., *Contract Furniture Refinishing & Maintenance Corp. v. Remanufacturing & Design Group, LLC*, 730 S.E.2d 708 (Ga. Ct. App. 2012) (circumstantial evidence from which a finding of trade secret misappropriation could be inferred was insufficient to survive summary judgment against defendant’s denial of misappropriation).

<sup>101</sup> Uniform Trade Secrets Act with 1985 Amendments (“UTSA”), Nat’l Conference of Comms. on Uniform State Laws (1985).

<sup>102</sup> 2023 New York Senate Bill No. 4729. Versions of this bill have been introduced in each legislative session since 2015.

<sup>103</sup> UTSA §§ 1–3.

<sup>104</sup> See *id.* § 3(a).

<sup>105</sup> See, e.g., Ala. Code. § 13A-8-10.4 (Supp. 1984); Ark. Stat. Ann. §§ 41-2201, 41-2207 (1977); CAL. PENAL CODE § 499c (Deering 1983 & Supp. 1984); COL. REV. STAT. § 18-4-408 (1973); FLA. STAT. ANN. § 812.081 (West 1981); GA. CODE. ANN. § 26-1809 (1983); ME. REV. STAT. ANN. tit. 17A, §§ 351, 352 (1982) (under theft statute); MASS. ANN. LAWS. ch. 226, § 30 (Michie/Law. Co-op. 1980) (under larceny statute); MINN. STAT. ANN. § 609.52 (West 1963); N.H. REV. STAT. ANN. §§ 637:1, 637:2 (1974); N.M. STAT. ANN. § 30-16-24 (1984); OHIO REV. CODE. ANN. § 1333.51 (Baldwin 1978); OKLA. STAT. ANN. tit. 21, § 1732 (West 1983); TENN. CODE ANN. § 39-3-1126 (1982); TEX. PENAL CODE ANN. § 31.05 (Vernon 1974); WIS. STAT. ANN. § 943.205 (West 1982 & Supp. 1984-1985).

<sup>106</sup> See UTSA § 7.

<sup>107</sup> See generally Sid Leach, *Anything but Uniform: A State-By-State Comparison of the Key Differences of the Uniform Trade Secrets Act*, Snell & Wilmer (2015).

cited six-factor test to aid in the definition of a trade secret: “(1) the extent to which the information is known outside of [the] business; (2) the extent to which it is known by employees and others involved in [the] business; (3) the extent of measures taken by [the owner] to guard the secrecy of the information; (4) the value of the information to [the business] and to [its] competitors; (5) the amount of effort or money expended by [the business] in developing the information; (6) the ease or difficulty with which the information could be properly acquired or duplicated by others.”<sup>108</sup>

Under the UTSA and corresponding state statutes, trade secret owners can file suit against anyone who misappropriates their trade secrets, which includes not only the party who originally took the trade secret, but also any other party who acquires the trade secret with knowledge that it was obtained by improper means. Trade secret protection can apply to both tangible and intangible information, although some states limit protection of certain information, such as customer information, to that in tangible form.

As noted above, the remedies for trade secret misappropriation include both injunctive relief and monetary damages. Under the UTSA, both actual and threatened misappropriation may be enjoined. Courts are authorized to enjoin parties that have misappropriated trade secrets for so long as the information remains a trade secret, and for an additional reasonable period of time if necessary to eliminate any commercial advantage from the misappropriation. Courts also have authority in exceptional circumstances to condition future use of the trade secret information upon payment of a reasonable royalty. Finally, courts have authority to compel parties to take affirmative actions to protect trade secrets.

The damages recoverable for misappropriation of trade secrets include both the actual loss caused by the misappropriation and any unjust enrichment accrued by the misappropriating party that is not taken into account in computing the actual loss. Most states’ laws also permit courts to enhance damages (under the UTSA, up to twice the damages award) if the misappropriation is willful and malicious. Trade secret owners may also be entitled to recover their reasonable attorneys’ fees upon a showing of willful and malicious misappropriation, but a trade secret defendant can seek to recover its attorneys’ fees if a claim of misappropriation is made in bad faith.

### **3. International**

Global protection of trade secrets is governed by treaty as well as by individual countries’ and regions’ unfair competition and trade secret laws. The Trade-Related Aspects of Intellectual Property Rights Agreement (“TRIPS”), in coordination with the Paris Convention, dictates that member states protect information not generally known that derives commercial value from being kept secret and has been subject to reasonable steps to maintain secrecy, leaving the scope of that protection up to member states.<sup>109</sup> Recent developments in trade

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<sup>108</sup> RESTATEMENT (FIRST) OF TORTS § 757 cmt b (1939).

<sup>109</sup> TRIPS § 7, Art. 39; Paris Convention Art. 10bis.

secret legislation worldwide indicate a trend toward increased protections and more standardization thereof.

In 2016, the EU set out its Directive on the Protection of Undisclosed Know-How and Business Information (Trade Secrets) against their Unlawful Acquisition, Use and Disclosure to harmonize EU member state legislation and set minimum standards.<sup>110</sup> The year 2016 also saw India's adoption of a National Intellectual Property Rights Policy initiative, suggesting potential for statutory protections of trade secrets in the future.<sup>111</sup> In 2019, China increased its trade secret protections for foreign investors, passing a new Foreign Investment law and amending its Anti-Unfair Competition Law to expand the scope of misappropriation remedies.<sup>112</sup>

### **C. Best Trade Secret Practices in Franchising**

Other than prioritizing the development of competitive methods, products and systems, franchisors' power to impact the "economic value" prong of the trade secret analysis is limited. Reasonable measures of secrecy are vital to trade secret protection and well within franchisors' control. Contractual limits on disclosure and use of trade secrets are typically set forth in franchise agreements and separate confidentiality and nondisclosure agreements between franchisors and franchisees or prospective franchisees. Regardless, even the strongest contractual terms can be defeated where parties lack sufficient notice that specific materials are confidential.<sup>113</sup> Therefore, it is important to prominently mark as "CONFIDENTIAL" those materials that contain trade secrets. Store them in locked locations and limit access to them.

## **III. COPYRIGHTS**

The role of copyrights is to protect and promote creative and original expression of ideas. As a general rule, copyrights are less critical to the franchised business model than trademarks and trade secrets. However, most franchised businesses create and use original works in the form of brand manuals, promotional materials, and even software applications, and such works are entitled to copyright protection.<sup>114</sup> This section will provide an overview of (1) the elements of a copyright; (2) copyright protection under U.S. and international law; and (3) the copyright infringement cause of action.

### **A. Basic Concepts**

Copyrights protect original, minimally creative authored works that are fixed in a tangible medium of expression, such as writings, music, images, audio or

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<sup>110</sup> EU Directive 2016/943 of 8 June 2016.

<sup>111</sup> Indian National Intellectual Property Rights Policy 9 (May 12, 2016).

<sup>112</sup> See AUCL; FIL.

<sup>113</sup> See, e.g., *Diamond Power Int'l, Inc. v. Davidson*, 540 F. Supp. 2d 1322, 1335 (N.D. Ga. 2007) (holding that party's failure to label a file as confidential or to track or otherwise regulate its use precluded trade secret protection in spite of general confidentiality agreements and security protections).

<sup>114</sup> See Mark S. VanderBroek and Jennifer M. D'Angelo, *Copyright Protection: The Forgotten Stepchild of a Franchise Intellectual Property Portfolio*, 28 FRANCHISE L.J. 84 (2008).

audiovisual recordings, and architectural works.<sup>115</sup> Only the copyrighted expression is protected, not the underlying ideas, methods, or concepts. These are always in the public domain, unless protected under other intellectual property rights, like patent or trade secret protection.<sup>116</sup>

A copyright is an exclusive right to copy, distribute, perform, display, and make derivative works of the copyrighted work, or to authorize others to do so.<sup>117</sup> Generally, the author of the protected work owns the copyright, but under the “works-made-for-hire” doctrine, that ownership can pass to an employer or commissioning party. An employee’s work automatically belongs to her or his employer if it was made within the scope of the employee’s employment. In the case of a specially commissioned work, such as a work created by an independent contractor, the work must fall within certain enumerated statutory categories and be the subject of a written agreement between the parties is a work-made-for-hire and the property of the commissioning party.<sup>118</sup>

The term of a copyright varies depending on the nature of the work and the date of publication.<sup>119</sup> For works published after 1978, copyright generally extends from creation and for 70 years following the death of the author. For works made for hire, the copyright extends for the lesser of: (1) 95 years from first publication; or (2) 120 years from creation.<sup>120</sup>

## **B. Copyright Protection**

### **1. United States**

To register a copyright with the U.S. Copyright Office, the owner must file an application form, pay a modest fee, and “deposit materials” representing the best edition of the copyrighted work.<sup>121</sup> Once the Copyright Office approves the application, it will issue a registration certificate, enabling the holder to enforce the copyright through federal litigation, record assignments and transfers of the copyright, and record the copyright with U.S. Customs to prevent importation of infringing material.

Registration is not required for a copyright to arise – the property right is created as soon as the work is fixed in a tangible medium of expression. However, copyright registration *is* required to bring suit for copyright infringement in the U.S.<sup>122</sup> Moreover, prompt registration enables the would-be infringement litigant to

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<sup>115</sup> 17 U.S.C. § 102.

<sup>116</sup> *See id.*

<sup>117</sup> 17 U.S.C. § 106.

<sup>118</sup> 17 U.S.C. § 101; *see also* U.S. Copyright Office Circular 30: Works Made for Hire, available at <https://www.copyright.gov/circs/circ30.pdf>.

<sup>119</sup> “Publication” is a term of art defined by statute as the distribution or offer to publicly distribute copies of a work to the public. Mere performance or display of the protected work falls outside this definition. *Id.*

<sup>120</sup> 17 U.S.C. § 302.

<sup>121</sup> *See generally* U.S. Copyright Office Circulars

<sup>122</sup> 17 U.S.C. § 411. *See also Fourth Estate Pub. Ben. Corp. v. Wall-Street.com, LLC*, 139 S. Ct. 881, 892 (2019) (holding that registration for purposes of 17 U.S.C. § 411 does not occur when “an application for registration is filed, but when the Register has registered a copyright after examining a properly filed

avoid the additional cost associated with expediting registration applications and can entitle the owner to statutory damages and attorneys' fees (which can far outweigh actual damages in certain cases).<sup>123</sup> The prospect of \$150,000 per infringement in statutory damages can be a powerful deterrent to potential willful infringers.

Copyright notice is another useful tool which, though not legally required,<sup>124</sup> is highly advisable for copyright protection. Including the year of publication, owner's name, and a © or other copyright designation on copyrighted material puts the public on notice that the work is protected and precludes defenses to infringement. (© Year, Owner)

## **2. International**

A number of treaties govern international cooperation for copyright protection, including the Berne Convention for the Protection of Literary and Artistic Works,<sup>125</sup> the related World Intellectual Property Organization ("WIPO") Copyright Treaty ("WCT"),<sup>126</sup> and TRIPS,<sup>127</sup> among others. The majority of countries recognize automatic copyright protection for nationals of treaty member states without any registration requirements.

The Berne Convention, in fact, contains language prohibiting member states from conditioning copyright protection on "formalities."<sup>128</sup> However, many countries have individual voluntary copyright registration mechanisms that can simplify copyright use and enforcement for U.S. copyright holders abroad.

## **C. Copyright Infringement**

The elements of a copyright infringement claim are: (1) ownership of a valid copyright; and (2) copying by defendant of constituent elements of the work that are original.<sup>129</sup> In the absence of direct evidence of copying, an infringement plaintiff can show evidence that the defendant had access to the protected work and that the infringing work is substantially similar.

Copyright infringement litigants must contend with a number of copyright-specific affirmative defenses including the notable fair-use doctrine, which permits limited use of a copyrighted work for "purposes such as criticism, comment, news reporting, teaching, scholarship, or research."<sup>130</sup> Courts assess fairness case-by-case based upon four factors: "(1) the purpose and character of the use, including

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application.")

<sup>123</sup> 17 U.S.C. § 504.

<sup>124</sup> Except for works published prior to March 1, 1989.

<sup>125</sup> 828 U.N.T.S. 221 (1886).

<sup>126</sup> 2186 U.N.T.S. 121 (1996).

<sup>127</sup> Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, 1869 U.N.T.S. 3 (1994).

<sup>128</sup> The United States requirement that a copyright be registered before its owner can pursue copyright infringement litigation in US federal courts is inapplicable to foreign nationals for this reason.

<sup>129</sup> *Feist Publ'ns, Inc. v. Rural Tel. Serv. Co.*, 499 U.S. 340, 361 (1991).

<sup>130</sup> 17 U.S.C. § 107.

whether such use is of a commercial nature or is for nonprofit educational purposes; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (4) the effect of the use upon the potential market for or value of the copyrighted work.”<sup>131</sup>

#### **IV. PATENTS**

Patents provide temporary but comprehensive monopoly over inventions in exchange for public disclosure. They are the near inverse of trade secrets, the protection of which can be perpetual but cannot prevent competitors from developing and using protected information through proper means. When faced with the choice between seeking formal patent protection and informally maintaining trade secrets, franchisors tend to choose the perpetual but less certain trade secret option. Nevertheless, patents can be an important feature of franchisor IP portfolios in certain industries.<sup>132</sup>

Patent law is complex and may involve issues that reach beyond legal expertise into the highly technical and scientific areas. As such, it is important to seek specialized counsel when evaluating patent issues. Competent franchise attorneys should nevertheless be familiar with the basics of patent law and able to recognize patent issues when they arise. This section will provide an overview of: (1) basic patent concepts; (2) domestic and international patent protection; (3) assignment and licensing; and (4) patent infringement.

##### **A. Basic Concepts**

A patent gives its owner a temporary monopoly-- the right to exclude others from making, using, offering for sale, selling, or importing the protected invention.<sup>133</sup> The USPTO issues three types of patents:

- utility patents, which may be obtained by “whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof”,<sup>134</sup>
- design patents, which may be obtained by “whoever invents any new, original and ornamental design for an article of manufacture”;<sup>135</sup> and
- plant patents, which may be obtained by “whoever invents or discovers and asexually reproduces any distinct and new variety of plant”.<sup>136</sup>

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<sup>131</sup> *Id.*

<sup>132</sup> See, e.g., *Automated Beverage System*, U.S. Patent No. 6,053,359A (filed Dec. 22, 1997 by McDonalds Corp.).

<sup>133</sup> 35 U.S.C. § 154. Subject to limited exceptions, the term for a patent begins on the date of issue and ends 20 years from the date the application was filed. See *id.*

<sup>134</sup> 35 U.S.C. § 101.

<sup>135</sup> 35 U.S.C. § 171.

<sup>136</sup> 35 U.S.C. § 161.

Utility patents are the most commonly issued. In order to be eligible for a utility patent, a claimed invention must be new, useful, and non-obvious. The novelty prong is generally satisfied unless “(1) the claimed invention was patented, described in a printed publication, or in public use, on sale, or otherwise available to the public before the effective filing date of the claimed invention; or (2) the claimed invention was described in a patent issued...or in an application for patent published...effectively filed before the effective filing date of the claimed invention.”<sup>137</sup> The pre-existing materials is known as prior art. An invention is useful if its utility is “readily apparent” or if the application asserts “specific and substantial utility” that would be credible to someone with ordinary skill in the relevant field.<sup>138</sup> However, even if a claimed invention is technically new, it will fail the test for non-obviousness if the differences between the claimed invention and prior art would be obvious to a person having ordinary skill in the relevant field.<sup>139</sup> Claimed inventions for design patents need not be non-obvious, but must be primarily ornamental (not functional) in nature.<sup>140, 141</sup>

## **B. Patent Protection**

### **1. United States**

Prior to March 2013, the United States was unique in issuing patents to the “first-to-invent.” The U.S. has since joined the rest of the world in following a “first inventor to file” policy pursuant to the 2011 America Invents Act.<sup>142</sup> In order to obtain patent protection, an inventor must submit a patent application to the USPTO before the claimed invention is described in any patent or patent application in the U.S. or abroad. The utility patent application consists of (1) a written specification with claims; (2) supplemental drawings as necessary; (3) an oath or declaration of inventorship; and (4) an application fee to cover the cost of filing, prior art search, and examination.<sup>143</sup> The effective filing date, highly significant in the “first-to-file” determination, is the date the USPTO receives the specification.<sup>144</sup>

The USPTO examines the over 500,000 applications it receives each year in sequential order, few of which are accepted as filed. The patent examiners issue Office Actions detailing reasons for rejection, and applicants may amend their submissions and/or submit explanations in response.<sup>145</sup> Aggrieved applicants may appeal to the Patent Trial and Appeal Board and subsequently to federal court.<sup>146</sup>

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<sup>137</sup> 35 U.S.C. § 102.

<sup>138</sup> UNITED STATES PATENT AND TRADEMARK OFFICE, Manual of Patent Examining Procedure, § 2107 (2013).

<sup>139</sup> 35 U.S.C. § 103.

<sup>140</sup> See 35 U.S.C. § 171.

<sup>141</sup> Requirements for plant patentability delve into botanical intricacies beyond the scope of this paper. See 35 U.S.C. § 161.

<sup>142</sup> Leahy-Smith America Invents Act, Pub. L. No. 112-29, 125 Stat. 284 (2011) (codified throughout 35 U.S.C.).

<sup>143</sup> 35 U.S.C. § 111.

<sup>144</sup> *Id.*

<sup>145</sup> See 35 U.S.C. § 132.

<sup>146</sup> See 35 U.S.C. §§ 134, 141, 145.

Once the application has been approved and relevant fees paid, the USPTO will issue the patent. To retain patent protection for its full term, a patent holder must pay additional maintenance fees at 3.5, 7.5, and 11.5 years from the date of issue.<sup>147</sup>

## **2. International**

US patent rights provide protection only within the territorial United States. It is therefore necessary to file in each country where protection is sought, but systems of international cooperation mitigate the burden and streamline the process of multinational patent protection. The Paris Convention for the Protection of Industrial Property (signed by 177 countries) provides that application for a patent in any member state gives a year's right of priority, during which an inventor may file in any other member state and receive the effective filing date of the first application.<sup>148</sup> The Patent Cooperation Treaty ("PCT"), which has over 150 member states, established the PCT International Patent System, providing for centralized filing procedure and standardized applications.<sup>149</sup> A PCT priority date lasts 18 months before the applicant must begin national phase procedures in the individual countries. Both treaties are administered by the WIPO.

### **C. Assignment and Licensing**

Patents, like other forms of intellectual property, are freely transferable and may be assigned, licensed, or bequeathed. Assignment is particularly common in circumstances of employment or commission, like the "works-for-hire" doctrine of copyright law. Inventors who create claimed or patented technology within the scope of their employment or independent contract commission must execute an assignment and file it with the USPTO for recordation in order for their employers or commissioners to have any official ownership interest in the invention.<sup>150</sup> Such filings are standard and generally filed concurrently with the patent application.

Patent licenses may be exclusive or non-exclusive and their terms may be diverse, providing for geographical and temporal scope, payment of royalties, et cetera. The USPTO and the WIPO provide forums in which patent holders can offer their patents for license or sale. Since patents do not grant the right to manufacture, use, or sell inventions but rather grant the right to preclude others from doing so, patent licenses can function much like covenants not to sue.<sup>151</sup>

### **D. Patent Infringement**

Patent infringement is defined as the manufacture, use, sale or offer for sale, or importation of a patented invention during its protected term without the

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<sup>147</sup> 35 U.S.C. § 41.

<sup>148</sup> Paris Convention for the Protection of Industrial Property, 21 U.S.T. 1583; 828 U.N.T.S. 305 (1883).

<sup>149</sup> Patent Cooperation Treaty, 28 U.S.T. 7645; 1160 U.N.T.S. 231; 9 I.L.M. 978 (1970).

<sup>150</sup> See 35 U.S.C. § 261.

<sup>151</sup> See Marc Malooley, *Patent Licenses Versus Covenants Not to Sue: What Are the Consequences?*, Brooks Kushman P.C. (2015).

consent of the patent holder.<sup>152</sup> Patent infringement is a federal cause of action subject to the exclusive appellate jurisdiction of the Court of Appeals for the Federal Circuit.<sup>153</sup>

Patents have a rebuttable presumption of validity, but invalidity of the patent is an affirmative defense to patent infringement.<sup>154</sup> A finding of invalidity in federal court can result in the invalidation of the patent and loss of all patent rights. Challenges to validity can include:

- Failure of any condition for patentability under 35 U.S.C. § 101
  - Subject-matter (“process, machine, manufacture, or composition of matter”)
  - Novelty
  - Usefulness
  - Non-obviousness
- Failure to fully disclose under 35 U.S.C. § 112
- Defectiveness under 35 U.S.C. § 251

Other affirmative defenses to patent infringement include non-infringement and (in certain limited circumstances) prior commercial use.<sup>155</sup> Patent litigation is costly, with median fees ranging from \$700,000 to \$4,000,000 in 2019.<sup>156</sup> Especially in international venues, where costs can sometimes far outweigh damages remedies, parties may prefer alternative dispute resolution methods such as mediation and arbitration.

## **V. FRANCHISING AND INTELLECTUAL PROPERTY**

### **A. Ownership of IP**

#### **1. Separate entity or franchisor entity**

There are multiple ways to structure intellectual property ownership for a franchise company. For instance, franchisors may own intellectual property or may create an intellectual property holding company to own the intellectual property. Using an intellectual property holding company can insulate the franchisor from certain types of liability and/or protect the intellectual property from the bankruptcy of a franchisor. Moreover, having all intellectual property owned by one holding company, then licensed down to more than one franchisor entity, enables the holding entity to use the consolidated intellectual property as collateral, rather than obtaining financing through each separate franchisor entity. Holding companies also are often used strategically for tax benefits. A franchisor may gain tax advantages by locating the holding company in a tax-friendly country (such as Bermuda, Cayman Islands, or Ireland), or, if in the United States, a tax-friendly

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<sup>152</sup> 35 U.S.C. § 271.

<sup>153</sup> 28 U.S.C. § 1338; 1295.

<sup>154</sup> 35 U.S.C. § 282.

<sup>155</sup> *Id.*; 35 U.S.C. § 273.

<sup>156</sup> American Intellectual Property Law Association, 2019 Report of the Economic Survey 50 (2019).

state (such as Nevada or Delaware), and licensing the intellectual property to the franchisor entity in exchange for royalties.

## **2. Intercompany License Agreements**

If any intellectual property to be licensed to franchisees is not owned by the franchisor, the holding company and the franchisor should enter into a written license agreement or license agreements that permit the franchisor to sublicense the intellectual property to the franchisees. Different types of intellectual property might need to be licensed separately so the parties need to address issues clearly and appropriately. For instance, trademark licenses must include appropriate quality control restrictions and address good will to avoid the license being deemed a naked license whereby the trademark owner loses its rights.<sup>157</sup> In contrast, other types of intellectual property licenses may not need these same provisions.

### **B. Protecting Intellectual Property prior to Franchising**

#### **1. Trademark Registration**

A franchisor should ensure that all key trademarks to be used by franchisees in the franchised business are federally registered before moving forward with a franchise offering. Because trademark rights in the U.S. are based upon use, not registration, owning a federal registration does not ensure protection from a third party with prior use. However, the trademark registration process does typically identify marks that third parties have registered, providing some comfort to both licensors and users. Moreover, a federal registration enables nationwide expansion with less risk, because any user who adopts the same or a similar mark after the registration issued must stop using the mark once the geographic territories of use overlap.<sup>158</sup>

Several states have business opportunity laws that apply to relationships where a purchaser acquires, for a fee, the right to operate a business selling products and services and the seller agrees to provide marketing assistance, site selection assistance, a market for the products or services and to re-purchase unused inventory. Although business opportunities are different from franchises, due to the broad way in which a “business opportunity” is defined under some of these state laws, franchises can be included within that definition. And similar to franchise registration laws in certain states,<sup>159</sup> several state business opportunity laws require sellers of business opportunities to comply with registration or disclosure requirements in order to offer or sell a business opportunity in their state. Franchise sales do not typically come under the reach of business opportunity statutes, however, if a franchisor does not have a registered trademark in Connecticut, Georgia, Louisiana, Maine, North Carolina or South Carolina, the

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<sup>157</sup> See, e.g., *Freecycle Sunnyvale v. Freecycle Network*, 626 F. 3d 509 (9<sup>th</sup> Cir. 2010) (finding a mark abandoned based on licensing without adequate quality controls).

<sup>158</sup> See *Dawn Donut Co. v. Hart's Food Stores, Inc.*, (267 F.2d 358 (2d Cir. 1959)); see also, *Guthrie Healthcare System v. ContextMedia, Inc.*, 826 F.3d 27 (2d Cir. 2016).

<sup>159</sup> California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin.

franchisor must comply with the business opportunity law prior to selling any franchises in the state. Once a franchisor obtains a federal registration for the principal mark used to identify the franchise brand, and assuming that the franchisor offers franchises in compliance with the Federal Trade Commission Franchise Rule, the states with business opportunity laws will no longer be a concern with the exception of Connecticut, Florida, Kentucky, Nebraska, Texas, and Utah where the franchisor needs to obtain an exemption from the reach of the business opportunity law.

## 2. Copyright Registration and other IP Protection

Franchisors should obtain, or file applications for, copyright registration for all key content that will be provided to franchisees including, but not limited to, content that franchisees will use publicly. As discussed previously, in order to bring suit for copyright infringement, the copyright owner must have registered the copyrights. Thus, registering copyrights in content before it is distributed both places the franchisor in a position to take action quickly in the event of infringement and creates a strong disincentive for unauthorized copying. Damages for infringement of copyrights that were registered prior to the commencement of infringement are significantly higher than those available for copyrights registered after the fact and can include attorneys' fees. Unless copyrights are registered early and kept up to date (by registering subsequent versions), enforcement might not be cost-effective. Franchisors should consider protecting both public content (such as websites) and behind-the-scenes content (such as operations and training manuals or proprietary software) through copyright registration.

There often is a hesitation to register copyrights in certain works due to concern that the submission to the Copyright Office makes the proprietary information public. Copyright deposits (the copy of the material for which protection is sought that one submits to the Copyright Office) do not become public; only the fact of the registration and basic information does.<sup>160</sup> Third parties may obtain copies only in the context of litigation relating to the copyright.<sup>161</sup> Software may be registered with a claim of trade secret protection.<sup>162</sup> If any non-software deposits contain trade secrets, consider redacting the trade secrets from the deposit copy. In many cases, what would be claimed as a trade secret (formulas or data) are not protectable under copyright law.<sup>163</sup>

Franchisors also should consider what other types of intellectual property protection are appropriate and ensure that any necessary steps are taken to obtain that protection before embarking on franchising. While some kinds of intellectual property are not obtainable before a launch (such as certain kinds of trade dress

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<sup>160</sup> Circular 18, *Privacy: Copyright Public Records*, U.S. Copyright Office (<https://www.copyright.gov/circs/circ18.pdf>).

<sup>161</sup> Circular 6, *Obtaining Access to and Copies of Copyright Office Records and Deposits*, U.S. Copyright Office (<https://www.copyright.gov/circs/circ06.pdf>).

<sup>162</sup> Circular 61, *Copyright Registration of Computer Programs*, U.S. Copyright Office (<https://www.copyright.gov/circs/circ61.pdf>).

<sup>163</sup> Circular 33, *Works Not Protected by Copyright*, U.S. Copyright Office (<https://www.copyright.gov/circs/circ33.pdf>).

that rely on secondary meaning created through use), many kinds of intellectual property (patent protection and trade secrets for example) must be properly handled initially or they will become unavailable or subject to validity challenges when it comes time to enforce them.

### **C. Addressing Intellectual Property in the Franchise Agreement**

The primary intellectual property-related issues that must be addressed in the franchise agreement are: definitions, ownership, use, sublicensing restrictions, restrictive covenants, and confidentiality.

#### **1. Definitions**

Franchisors should clearly define the intellectual property that they are licensing to franchisees in the franchise agreement so that it is clear to the franchisee both what the franchisor claims as proprietary and how each piece of intellectual property fits within the system that is licensed to the franchisee. Definitions might need to be both general – to ensure continued applicability as the franchised system evolves – and specific – elements of trade dress, particularly those that are not inherently distinctive, should be spelled out clearly. Definitions also need to be consistent throughout various documentation, such as the operations manual.

#### **2. Ownership**

The franchise agreement should make clear that as between the franchisor and franchisee, the franchisor owns all rights to the intellectual property. This claim of ownership should include goodwill that is created through use of the marks and to any intellectual property created by the franchisee itself, or its owners, employees or agents, such as new menu items. A franchisor might choose to restrict the right of a franchisee to insert franchisee-created elements into the operation of the franchise; however, if it does not, or if a franchisee creates protectable rights contrary to a restriction, the franchisor should own them. Franchisees conceivably could create a new way of accomplishing a task or making a product, which could be protected via patent or as a trade secret, or a new brand, protected via trademark, or artwork or photographs, protected as copyrights.

The franchise agreement should have all such creations assigned automatically to the franchisor, with the franchisee agreeing to cooperate in the assignment and protection (which typically would be at franchisor's expense). (Works made for hire, a copyright concept, is often misunderstood and applies to only limited types of creations; thus the need for an express assignment.<sup>164</sup>) The franchisor's ownership of new developments enables exploitation of creativity for the benefit of the entire franchise system.

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<sup>164</sup> See, Section 101 of the Copyright Act; U.S. Copyright Office, Circular 30, *Works Made for Hire*.

While data obtained through operation of a franchised business by a franchisee might not always be protectable as intellectual property,<sup>165</sup> ownership and use of the data should be addressed contractually if the data has value to the franchisor, bearing in mind any data security or privacy laws that may be implicated.

### **3. Use and Sublicensing Requirements and Restrictions**

The franchise agreement needs to identify what the franchisee may and may not do with each element of intellectual property. All franchise agreements should grant the franchisee the right (typically non-exclusive) and obligation to use the trademarks and the brand's operating system to operate the franchised business only in accordance with the franchisor's quality standards and specifications. The specifications typically are contained in the franchisor's operations manuals, which franchisors generally retain the right to update and change unilaterally.

Some or all of the intellectual property to be used by the franchisee will not be sublicensable by the franchisee – the trademarks, for instance; other intellectual property will be licensed to the franchisee with the intent that the franchisee will sublicense it to its customers – such as software in certain types of businesses. Some intellectual property will be used publicly (the marks) and some will be back-office only (operations manuals and training materials).

In addition to clearly specifying the rights granted (such as a non-exclusive license only for a specific single location), the franchise agreement should specify rights not granted to the franchisee (such as the right to open additional franchised businesses or to sublicense or to use the licensed intellectual property for any purpose other than operating the franchised business) and those retained by the franchisor (such as the right to license the marks and system to others that may compete directly with the franchisee, in any channel of distribution or in any geographic region not specifically excluded).

### **4. Restrictive Covenants**

Franchise agreements typically contain non-solicitation provisions and non-competition provisions. Non-solicitation provisions typically prohibit a former franchisee from exploiting the contacts provided by the franchisor or created through the franchise relationship, such as customers, vendors and suppliers.

Non-competition provisions prohibit franchisees from engaging in competitive business activities and typically apply both during (in-term) and after the end of (post-term) the franchise relationship. From the perspective of the franchisor, a non-compete is designed to restrict a franchisee from taking valuable business rights (which may or may not be protected as intellectual property) and goodwill and using it to improperly and unfairly compete with businesses operating within the franchisor's system. In deciding whether and how to enforce a non-

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<sup>165</sup> Compilations of data can be protectable as copyrights or trade secrets in certain circumstances.

competition provision, courts look to balance the right of the franchisor to protect its intellectual property and system with the need of the franchisee to continue earning a living. Interpretation and enforcement of non-compete agreements vary by state but typically are based upon reasonableness, looking to the factors of geographic scope, scope of restricted activities, and the duration of the restriction (post-termination). Some states will enforce only covenants that are limited to the territory in which the franchisee operated, while some will enforce broader covenants. Some states will narrow covenants to make them reasonable (“blue pencil”), while others will refuse to enforce overbroad covenants entirely.

## **5. Confidentiality**

The franchise agreement should include confidentiality restrictions (non-disclosure covenants) that cover any confidential information that will be shared with the franchisee, with specific emphasis on any item that the franchisor intends to claim as a trade secret. The confidentiality covenants should include tangible and intangible information and include an acknowledgement that the franchisee has been given access to specific confidential information.

### **D. The Franchise Disclosure Document**

Franchisors are required to disclose information in their Franchise Disclosure Document (FDD) related to the intellectual property being licensed to the franchisee. These disclosures are detailed below, namely Item 13 (trademarks), Item 14 (patents, copyrights, and other proprietary information), Item 15 (a franchisee’s obligation to personally participate in the actual operation of the franchised business), and Item 16 (restrictions on what franchisees may sell).<sup>166</sup> In addition, litigation or arbitration enforcing a franchisor’s intellectual property rights may need to be disclosed in Item 3 (litigation).

#### **1. Item 3**

As discussed below, a franchisor may need to file litigation or arbitration to enforce its intellectual property rights from time to time. A franchisor’s enforcement of its contractual and intellectual property rights has implications for the FDD. Specifically, the FTC mandates that a franchisor disclose information related to franchisor-initiated lawsuits in certain circumstances. In Item 3, a franchisor must disclose, among other things, litigation in which it:

[w]as a party to any material civil action involving the franchise relationship in the last year. For purposes of this section, “franchise relationship” means contractual obligations between franchisor and franchisee directly relating to the operation of the franchised business (such as royalty payments and training obligations). It does not include suits involving suppliers or other third parties, or indemnification for tort liability.<sup>167</sup>

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<sup>166</sup> FTC, *Franchise Rule Compliance Guide*, Bus. Franchise Guide (CCH) ¶ 6,086 (2008).

<sup>167</sup> 16 C.F.R. § 436.5(c)(1)(ii).

This disclosure requirement only arises in connection with actions related to franchisees, not suppliers or other third-parties. This disclosure requirement should prompt franchisors to be prudent about the types of suits they file against their franchisees: a franchisor quick to react and file claims regarding matters that could have been easily resolved outside of court may serve as a warning sign to potential franchisees, thereby harming franchise sales. On the other hand, a disclosure of several suits for the enforcement of brand standards may signal to franchisees that the franchisor takes its duty to police the brand seriously and is not afraid to bring an action in order to maintain brand uniformity.

## **2. Item 13**

In Item 13, a franchisor must list its principal trademarks, namely those that identify the franchise system and the goods or services sold or offered by the franchisee. Franchisors must disclose whether the marks are registered federally or in a U.S. state, and whether any claims, settlements, or agreements affect the ownership, use, or licensing of the marks. If a franchisor does not own a federally registered trademark, then it must disclose that in Item 13 and explain the risks of not having such a registration.<sup>168</sup>

## **3. Item 14**

Item 14 requires a franchisor to describe all other types of intellectual property licensed with the franchise, namely, patents and patent applications, copyrights, trade secrets, rights of publicity (unless more appropriately disclosed in Item 18), and other proprietary information. As with Item 13, the franchisor must disclose all legal proceedings, settlements, and restrictions that affect these proprietary rights or limit a franchisee's ability to use the intellectual property. The disclosure may, in some circumstances, include an attorney's opinion regarding disclosed litigation or administrative proceeding or determination.<sup>169</sup>

## **VI. ENFORCEMENT OPTIONS AND STRATEGIES**

At some point, most franchisors will necessarily need to enforce their intellectual property rights. Disputes most often arise between franchisors and franchisees at the end of the franchise relationship, but can also arise with current franchisees during the franchise relationship or at any time with unaffiliated third parties outside of the franchise system. In all instances, it is important for the franchisor to take prompt action to protect its most important intangible assets—its intellectual property, including trademarks and trade secrets—and to protect against improper and unauthorized competition, which could threaten the franchisor's own business, that of its franchisees, and the value of the franchise system as a whole. Among other things, the misappropriation of a franchisor's intellectual property and the disclosure of its confidential information can harm the franchisor's goodwill, dilute the value of the brand, and discourage potential franchisees from entering the franchise system. A franchisor that fails to protect its

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<sup>168</sup> *Id.*, at pp. 74-76.

<sup>169</sup> *Id.*, at pp. 76-77.

intellectual property risks its entire system.

## **A. Potential Infringers**

Franchisors typically find themselves in an intellectual property dispute with franchisees when the franchise agreement is terminated, and the franchise relationship ends. In these disputes, typically, the now-former franchisee continues using the franchisor's intellectual property after the relationship ends. When that happens, the franchisor must carefully evaluate its available remedies. Such options may include: (i) seeking injunctive relief; and (ii) filing suit or initiating an arbitration seeking monetary damages to compensate the franchisor for its losses.<sup>170</sup>

To protect the franchise brand, a franchisor may also be required to enforce its intellectual property rights against third parties who are not franchisees. As discussed below, cease-and-desist letters are typically used to put the infringing party on notice of the franchisor's intellectual property rights and demand a stop to the infringement. Unlike a franchisee, a third-party infringer may truly be unaware of the franchisor's existence or the existence of a particular mark. Depending on the magnitude of the third party's infringement, a franchisor may consider seeking injunctive relief. Damages against third-party infringers may also be available.

A franchisor may also find that third-parties may sell infringing products on third-party platforms, such as eBay, Amazon, and Etsy. These platforms argue they are not liable for the infringement on the theory that they are not the actual seller but merely the platform for the third-party to sell the goods. Rather than incurring additional cost and expense arguing with the online retail giants on the merit of their defense, these platforms typically provide a portal to file formal complaints. The platform will typically remove the listing from the platform's website. This can be an effective strategy, especially when there are multiple cases of infringement on a particular platform.

## **B. Enforcement Options**

### **1. Cease and Desist Letters**

Upon learning of the infringement of its intellectual property rights, a franchisor's first step is usually to send the infringing party—whether a current or former franchisee or a third party—a cease-and-desist letter demanding that the infringing conduct stop, unless the nature of the infringement is such that the franchisor cannot afford to wait to see if the infringing party complies. Depending upon the circumstances and the nature of the infringement, however, franchisors may want to consider other steps prior to sending a cease-and-desist letter such

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<sup>170</sup> It is also not uncommon for a current franchisee to violate the franchisor's intellectual property right—for example, by using the franchisor's name and trademarks in connection with unauthorized products or services, or by disclosing the franchisor's confidential information and trade secrets to a competing business. If a breach of any restrictive covenant related to intellectual property occurs during the term of the franchise agreement the franchisor might also declare a default and terminate the agreement. This should only be attempted if the agreement allows for termination under the circumstances and if the franchisor first complies with any applicable notice and cure provisions required by the franchise agreement or state law.

as contacting the infringer by telephone or email to seek compliance, particularly with a third party who may be unaware of a franchisor's ownership of the trademark or other intellectual property. Also, when sending cease-and-desist letters, franchisors should consider the tone of the letter, particularly if the infringer is a small business or other sympathetic party (versus a large corporation or competitor), again depending on the nature of the infringement. Recipients of a demand letter may post it on social media to try to demonstrate how unnecessarily aggressive a trademark owner was, when a simple phone call or less aggressively worded letter would have netted the desired results. And while a franchisor may successfully deal with an infringer through a strongly worded cease-and-desist letter, it may have needlessly cause damage to the goodwill of the brand if there is backlash from the posting of the more formal and intimidating cease-and-desist letter on social media. If the franchisor is unable to quickly gain compliance with less formal demands, then proceeding with a formal demand letter may be in order.

The demand letter should set forth the franchisor's ownership of the trademark or other intellectual property at issue, explain that the infringing party's conduct constitutes improper infringement or misappropriation, and demand cessation of such conduct. The letter should set a prompt deadline to stop the infringing activity (with evidence of compliance). If the infringer does not comply or does not respond to the demand letter, the franchisor must decide whether to proceed with legal action. The purposes of sending a demand letter include putting the infringing party on notice of the franchisor's intellectual property rights, demanding cessation of the infringing conduct, and documenting the franchisor's efforts to protect its intellectual property rights and resolve the dispute without the need for judicial intervention. In addition, if the infringement continues following delivery of the cease-and-desist letter, the plaintiff can argue that treble damages are appropriate because the continued use shows that such infringement is willful. In its demand letter, the franchisor should instruct the infringing party to preserve all documents relevant to the dispute, including emails and other electronic documents. Upon sending a demand letter, the franchisor should also take appropriate steps to ensure preservation of its own documents, given its anticipation of the possibility of future litigation.

If the dispute solely involves an Internet service provider, in-house counsel can forward the demand letter to the ISP who will, through the take down procedures, remove the image or use.

Sending a strongly drafted cease-and-desist letter to a franchisee (who would be aware of the franchisor's rights) to stop the infringement is typically a helpful and cost-effective first step. This will put the infringer on formal notice of the infringement, and usually, will be effective in stopping the infringement if properly drafted. However, there is no requirement that a cease and desist letter be sent as a prerequisite to filing suit, so sometimes franchisors will file a lawsuit contemporaneously with sending the cease and desist letter. In other circumstances, franchisors will opt to enclose a copy of the proposed lawsuit to the infringer with the explanation that the suit will be filed if the franchisee does not cease and desist, which could be more impactful.

## 2. Injunctive Relief

A franchisor must take prompt action to stop improper and unauthorized competition and misappropriation and disclosure of its intellectual property. This is especially crucial for trade secrets and other proprietary information. Lack of immediate attention could imperil the franchisor, the franchise system, its franchisees, and the brand's value. Moreover, if such activities dilute the franchisor's brand, prospective franchisees may be discouraged from entering the franchise system.

Therefore, if sending a strongly worded cease-and-desist letter does not stop the conduct, a franchisor's next step is to pursue legal action. The relief a franchisor seeks will often include an injunction because stopping the infringing conduct is often the franchisor's most important business objective. An injunction is an order from the court requiring the infringer to stop the infringing conduct. Often, a franchisor's ability to obtain an early injunction is critical to the ultimate resolution of the case. If a franchisor intends to seek injunctive relief, it is important for the franchisor to act quickly. A franchisor's failure to act promptly could be used against it to demonstrate a lack of irreparable harm resulting from the conduct at issue or to support a laches or estoppel argument. In addition, because damages from certain types of infringement or misappropriation can be difficult to prove with certainty, obtaining early injunctive relief is often the most effective remedy available to a franchisor.

Although the terminology and specific requirements differ somewhat between jurisdictions, the typical forms of injunctive relief available include emergency temporary restraining orders ("TRO"), preliminary injunctions, and permanent injunctions. Federal Rule of Civil Procedure 65 governs TROs and injunctions in the federal courts.

### a. Temporary Restraining Orders

A TRO preserves the *status quo* until adjudication of the plaintiff's preliminary injunction request. Courts can enter TROs either with or without notice to the adverse party. Under appropriate circumstances, a TRO can be entered *ex parte* without notice to the defendant. Under Rule 65(b), a federal district court may issue a TRO without prior notice to the adverse party only if:

- (A) specific facts in an affidavit or a verified complaint clearly show that immediate and irreparable injury, loss, or damage will result to the movant before the adverse party can be heard in opposition; and
- (B) the movant's attorney certifies in writing any efforts made to give notice and the reasons why it should not be required.<sup>171</sup>

A movant in federal court typically seeks a temporary restraining order simultaneously with, or very close in time to, filing its initial complaint. The movant

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<sup>171</sup> FED. R. CIV. P. 65(b)(1).

must verify the facts upon which the temporary order is sought, either by filing a verification of the facts in the complaint or one or more affidavits. If the order is sought without notice, the movant must also file a certification regarding steps taken to notify the adverse party of the motion or reasons why notice should not be required.

*Ex parte* TROs issued by federal courts must be endorsed with the date and hour of issuance, must describe the injury and state why the injury is “irreparable,” and must state why the order was issued without notice.<sup>172</sup> TROs issued without notice may not extend longer than 14 days, unless the court extends the order prior to expiration or unless the adverse party consents to an extension.<sup>173</sup>

Rule 65 provides that where the court issues an *ex parte* TRO, the motion for a preliminary injunction “must be set for hearing at the earliest possible time, taking precedence over all other matters except hearings on older matters of the same character.”<sup>174</sup> Similarly, when a party challenges an *ex parte* TRO entered against it, the court must “hear and decide the motion as promptly as justice requires.”<sup>175</sup> Generally, TROs should be granted without notice only in “extraordinary situations.”<sup>176</sup> Where the adverse party has received advance notice of the hearing, the district court has discretion to convert the hearing into a preliminary injunction hearing.<sup>177</sup>

## **b. Injunctions**

A preliminary injunction is an injunction that remains in effect until the case is finally determined on the merits. Obtaining a preliminary injunction can often be one of the most critical steps in intellectual property infringement, misappropriation, or unfair competition cases. A permanent injunction is a final, and permanent, ruling on the merits of the plaintiff’s injunction claim.

Rule 65(a) governs preliminary injunctions, which require advance notice to the adverse party. The purpose of a preliminary injunction is to preserve the positions of the parties until trial, provided that the court finds, among other things, that the plaintiff has a substantial likelihood of success on the merits and that the plaintiff is likely to suffer irreparable harm if an injunction is not issued.

Generally, a franchisor seeking a preliminary injunction must establish each of the following four factors: (1) that the franchisor is substantially likely to succeed on the merits of its claims; (2) that the franchisor will suffer irreparable harm if the injunction is not entered; (3) that a balancing of the harms and equities favors issuing the injunction; and (4) that issuance of the injunction would be consistent

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<sup>172</sup> See *id.* at 65(b)(2).

<sup>173</sup> See *id.*

<sup>174</sup> See *id.* at 65(b)(3).

<sup>175</sup> See *id.* at 65(b)(4).

<sup>176</sup> See, e.g., *U.S. v. Kaley*, 579 F.3d 1246, 1261 (11th Cir. 2009).

<sup>177</sup> See, e.g., *Burk v. Augusta-Richmond County*, 365 F.3d 1247, 1262 (11th Cir. 2004).

with the public interest. This is a heavy burden, but one that is achievable in intellectual property and unfair competition cases, where the harm from infringement or misappropriation is often great. In order to obtain a permanent injunction at the conclusion of the litigation, franchisors generally must satisfy the same elements, but must have actually prevailed on the merits of their claims.

The two most critical factors are usually a determination of whether the party seeking the injunction is likely to succeed on the merits and whether the plaintiff can establish the likelihood it will suffer irreparable harm without an injunction. While courts employ different standards in analyzing likelihood of success, generally a franchisor must be prepared to present compelling and actual evidence of the infringement or evidence sufficient to establish a substantial likelihood that infringement is occurring in order to receive a preliminary injunction. Franchisors can accomplish this by submitting affidavits or declarations outlining the evidence of the infringement or, if a hearing is held, by presenting live witness testimony. If additional evidence is needed for a franchisor to meet its burden at the preliminary injunction stage, the franchisor should consider moving to take expedited discovery, even if prior to the normal discovery period. A franchisor seeking temporary or preliminary injunctive relief should be able to point to specific evidence and not rely merely on conclusory allegations. Documents and photographs confirming the defendant's wrongful conduct can be particularly persuasive.

Historically, courts often presumed the existence of irreparable harm in cases involving infringement of intellectual property, provided the other elements for injunctive relief were met. In 2006, however, the United States Supreme Court decided *eBay, Inc. v. MercExchange, L.L.C.* and reversed the long-standing rule that courts could presume irreparable harm in patent cases.<sup>178</sup> While *eBay* clearly applies in patent cases, lower courts have been divided in their application of *eBay* to other intellectual property cases. Though several courts have applied *eBay*'s rejection of an irreparable harm presumption to copyright cases, courts had been split on the extent to which *eBay* applies to trademark cases.<sup>179</sup> The 2020 TMA amended Section 34 of the Trademark Act of 1946 (15 U.S.C. § 1116) to provide for the presumption of irreparable harm in trademark actions. Even so, a prudent franchisor seeking an injunction in a trademark case will, like in any other injunction case, make an affirmative showing that infringement of its trademarks poses a risk of irreparable harm, including harm to the franchisor's reputation, goodwill, the brand, and the franchise system as a whole. Presenting evidence of customer confusion, which is critical to establishing the merits a trademark infringement claim, will also be important to establishing the likelihood of irreparable harm. To bolster its showing of irreparable harm, a franchisor should also present evidence of its significant investment of time and resources in establishing the value of its trademarks and in obtaining the confidential information at issue. Including an acknowledgement by the franchisee in the

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<sup>178</sup> See 547 U.S. 388 (2006) (requiring patent plaintiffs to establish irreparable harm before an injunction may be granted).

<sup>179</sup> *Compare Audi AG v. D'Amato*, 469 F.3d 534 (6th Cir. 2006) with *N. Am. Med. Corp. v. Axiom Worldwide, Inc.*, 522 F.3d 1211 (11th Cir. 2008); *Rebel Debutante LLC v. Forsythe Cosmetic Group, Ltd.*, 799 F. Supp. 2d 558 (M.D.N.C. 2011).

franchise agreement that unauthorized use of the franchisor's trademarks will cause irreparable harm and entitle the franchisor to injunctive relief can be helpful, but is likely not binding on the courts.

Rule 65(c) provides that courts may issue preliminary injunctions or TROs only if the movant provides security in an amount deemed proper by the court. Therefore, in order to obtain such injunctive relief, a franchisor may be required to post a bond or other security in a sufficient amount to protect the enjoined party if it is later determined it was wrongfully restrained. While including a provision in the franchise agreement that the franchisor is not required to post a bond when seeking injunctive relief can be helpful, courts are generally not bound by such provisions.<sup>180</sup>

Common defenses asserted by franchisees to franchisor injunction claims include that the franchisor failed to submit sufficient evidence to show irreparable harm, the franchisor's unreasonable delay in bringing its claim, the franchisor's failure to take sufficient steps to stop other similar prior infringement, or that the franchisor has an adequate remedy at law (i.e., monetary damages), and, therefore, injunctive relief is not appropriate or necessary. In the case of improper competition by a former franchisee, if the franchisor has not taken reasonable efforts to try to re-establish a franchise location in the territory, the franchisee may point to that fact as evidence of lack of irreparable harm. Franchisees often also try to argue that a balancing of the equities requires denying the injunction because an injunction will cause greater damage to the franchisee than to the franchisor if the injunction is denied. If, however, the harm to the franchisee that would result is due to the franchisee's own wrongdoing, this argument often fails.

An injunction from a federal court "binds only the following who receive actual notice of it by personal service or otherwise": (a) the parties; (b) the parties' officers, agents, servants, employees, and attorneys; and (c) "other persons who are in active concert or participation" with the parties or their representatives.<sup>181</sup> Some courts have applied an aiding and abetting or privity analysis to this "active concert" standard.<sup>182</sup> Given the notice requirement, franchisors should, upon obtaining an injunction, immediately notify the enjoined party, if the injunction was entered on an *ex parte* basis, and any third parties with whom the enjoined party is believed to be involved with respect to the infringing contact.<sup>183</sup> Rule 65(d)(2) allows courts to enforce injunctions more broadly than just against the enjoined entity itself, such as, for example, to enjoin associates and family members of franchisees from operating competing businesses in contravention of a non-

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<sup>180</sup> See, e.g., *Winmark Corp. v. Brenoby Sports, Inc.*, 32 F. Supp. 2d 1206, 1225 (S.D. Fla. 2014).

<sup>181</sup> FED. R. CIV. P. 65(d)(2).

<sup>182</sup> See *Merial, Ltd. v. Cipla Ltd.*, 681 F.3d 1283, 1304 (Fed. Cir. 2012); *Blackard v. Memphis Area Med. Ctr.*, 262 F.3d 568 (6th Cir. 2001). The privity concept is generally restricted to the person so identified in interest with those named in the order that it would be reasonable to conclude that their rights and interest have been represented and adjudicated in the original injunction proceeding. However, non-parties generally are not bound if they acted for their own purposes wholly independent of the named party. See *Merial*, 681 F.3d at 1304-05.

<sup>183</sup> While parties can and should communicate the contents of an injunction to involved third parties, they should be careful when communicating with third parties, particularly if communicating beyond the terms of the order itself, to minimize the risk of a defamation or tortious interference claim.

competition covenant entered by the franchisee. Similar to enjoined parties, non-parties can be held in contempt of court for violating an injunction if they had notice of the injunction and acted in concert or participated with the enjoined party.<sup>184</sup>

If violated, injunctions may be enforced through either civil or criminal contempt proceedings. A civil contempt proceeding is initiated by filing a contempt motion. The movant bears the burden of proving, generally by clear and convincing evidence, that the defendant has ignored an order of the court.<sup>185</sup> Therefore, before moving for contempt, a franchisor should investigate, adequately document, and, if necessary, take discovery, including of third parties, to establish that a violation of an injunction has occurred. If the plaintiff meets this burden, the burden then shifts to the enjoined party to establish a valid defense, such as that compliance with the injunction was not possible, or that the enjoined party made reasonable efforts to comply, lack of notice of the order, or to dispute the plaintiff's interpretation of the scope or meaning of the injunction.

Generally, only civil contempt sanctions are awarded upon the showing of a violation of a civil injunction. The court's authority to levy sanctions is, however, generally broad, provided the sanctions are compensatory in nature. Among other relief, courts in civil contempt proceedings can issue fines to coerce the defendant to comply with the order and to compensate the plaintiff for its losses.<sup>186</sup> Depending upon the circumstances, various other contempt sanctions might also be available, including an award of lost profits, reasonable royalties, seizure of infringing products, treble damages, and an award of attorneys' fees and costs. A franchisor will be in a stronger position to seek meaningful contempt sanctions if it obtains evidence establishing the extent of the infringement and the specific amount of damages the franchisor has suffered, in addition to the fact that a violation has occurred.

### 3. Damages

As discussed above, the Lanham Act, DTSA, and various state statutes authorize recovery of monetary damages in the event of trademark infringement and trade secret misappropriation.

Before seeking to recover monetary damages from a franchisee, franchisors should first evaluate whether the franchisee or any guarantors have collectible assets. While concrete and quantifiable damages resulting from improper competition or intellectual property infringement or misappropriate can be difficult to prove (which is why injunctive relief is a critical remedy in this context), franchisors that are able to prove specific damages can seek

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<sup>184</sup> See *Additive Controls & Measurement Sys., Inc. v. Flowdata, Inc.*, 96 F.3d 1390, 1395-96 (Fed. Cir. 1996); FED. R. CIV. P. 71 ("When an order . . . may be enforced against a nonparty, the procedure for enforcing the order is the same as for a party.").

<sup>185</sup> See *Marshak v. Treadwell*, 595 F.3d 478, 485 (3d Cir. 2009) ("A plaintiff must prove three elements by clear and convincing evidence to establish that a party is liable for civil contempt: (1) that a valid order of the court existed; (2) that the defendants had knowledge of the order; and (3) that the defendants disobeyed the order."); *FTC v. Trudeau*, 579 F.3d 754, 776 (7th Cir. 2009); *Thomas v. Blue Cross & Blue Shield Assoc.*, 594 F.3d 814, 821 (11th Cir. 2010).

<sup>186</sup> See *Int'l Union, United Mine Workers of Am. v. Bagwell*, 512 U.S. 821, 829 (1994).

compensatory damages under the breached contract.<sup>187</sup>

Many franchise agreements contain liquidated damages provisions providing for a specific measure of recoverable damage upon termination of the franchise agreement. These calculations are often based on a percentage of past sales or royalties for a certain duration. Some franchise agreements similarly provide for liquidated damages in the event the current or former franchisee breaches the franchise agreement's confidentiality or non-compete provisions, though the ability to recover an agreed-upon amount of damages may undermine a franchisor's ability to obtain injunctive relief for such violation. State law governs liquidated damages provisions. Generally speaking, liquidated damages provisions are more likely to be enforced if they closely approximate the actual damages the franchisor is likely to suffer upon termination or if they, in good faith, attempt to estimate those damages.

Finally, if a franchisor terminates the franchise agreement as a result of the franchisee's breach, the franchisor may, depending on the jurisdiction, be able to recover lost future royalties as damages for the franchisee's breach.<sup>188</sup> Where available, the franchisor bears the burden of presenting sufficient evidence to calculate the lost future royalties in order to recover.<sup>189</sup>

### **C. IP Protection in the Internet Age**

Consumers rely increasingly on the Internet to obtain information about businesses and their products and services. Indeed, the Internet has fundamentally changed the way consumers interact with and relate to businesses and, as a result, their brands. The importance of the commercial Internet is reflected in the increasingly large amounts of time, effort, and resources businesses—both new and established—dedicate to developing and enhancing their online presence through the design and creation of websites, social media platforms, blogs, and other means.

The foundation of every business's online presence is its domain name; this is one of the primary ways consumers search for a business, its products, or its services. As a general rule, a business's domain name(s) should correspond to its trademarks, allowing each to reinforce the other and strengthen a business's branding and Internet presence.

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<sup>187</sup> Punitive damages are generally not available for breach of contract claims.

<sup>188</sup> Courts differ on whether a franchisor can recover lost future royalties following termination of a franchise agreement. In *Postal Instant Press, Inc. v. Sealy*, 43 Cal. App. 4th 1704 (Cal. Ct. App. 1996), the California Court of Appeals held that the franchisor was not entitled to recover lost future royalties from the terminated franchisee because (1) it was the franchisor's decision to terminate—not the franchisee's underlying breach—that was the proximate cause of the franchisor's loss of future royalties, and (2) an award of lost future profits would be unconscionable. On the other hand, applying a traditional contract analysis, other courts have held that a franchisor is entitled to all damages necessary to put it in a position equivalent to if the franchise agreement had remained in effect but for the franchisee's breach. See, e.g., *American Speedy Printing Ctrs., Inc. v. AM Mktg., Inc.*, 69 Fed. Appx. 692, 698 (6th Cir. 2003); *Legacy Academy, Inc. v. JLK, Inc.*, 330 Ga. App. 397, 402 (Ga. Ct. App. 2014) (holding franchisor was entitled to recover lost future royalties it would have received if the franchisee's breach had not prompted early termination of the franchise agreement).

<sup>189</sup> See *Legacy Acad.*, 330 Ga. App. at 402-405.

Business owners frequently ask how many domain names they should register. There is no correct answer. Many businesses choose to register their company names as well as significant brand names—and often, even frequently-used marketing terms and slogans—as domain names. For example, Nike, Inc.’s primary website resides at its domain name <nike.com>; however, the domain name <justdoit.com> (reflecting Nike, Inc.’s famous slogan) redirects to the primary site, and Nike, Inc. operates a separate site at air.jordan.com (also redirected from <airjordan.com>) dedicated to its AIR JORDAN line of basketball shoes.

Recently the selection of the top-level domains (“TLD”) for which a company should register has risen in importance. At one time, the universe of common TLDs available to a business was small and relatively manageable: for example, .com, .net and .org. Today, there are more than 1,000 TLDs available and deciding where to register can be a time-consuming and difficult process. Many businesses continue to register first under the .com TLD and, indeed, .com remains the most popular top-level domain. Many generic specialty TLDs that correspond to particular products or services are available including, .restaurant, .food, .retail, .hotel and .cars. Businesses can even, given significant resources, establish their own brand’s TLD, such as Barclay’s Bank, PLC did with <.barclays>. In addition to establishing a presence in the TLDs, businesses should consider registering under individual country-code top-level domains (“ccTLDs”) if, for example, a business has a significant presence or customer base in a particular country.

A substantial amount of trademark infringement today occurs on the Internet—and frequently involves domain names. Businesses should take proactive measures by registering obvious misspellings and alternate uses of their trademarks and corporate names. Another important reason for adopting domain names that correspond to a business’s trademarks is that it allows a business to rely on its trademark rights to address unauthorized registration and use of domain names that conflict with those trademark rights. The most common legal avenues for addressing trademark infringement arising from registration and use of domain names are the Uniform Domain-Name Dispute-Resolution Policy (UDRP), an administrative proceeding under the auspices of the Internet Corporation for Assigned Names and Numbers (“ICANN”), and The Anti-Cybersquatting Consumer Protection Act (ACCPA), a federal law that is part of the Lanham Act.

The UDRP is a rapid arbitration procedure designed to address situations in which infringing domain names are registered and used in bad faith specifically to take advantage of and trade on a trademark owner’s rights. UDRP proceedings are conducted on a limited, written record and offer no opportunity to take discovery. By their very nature, UDRP proceedings tend to be significantly less expensive than a suit filed under the ACCPA and are resolved relatively quickly. The sole remedy in an UDRP proceeding is the transfer of the domain name(s) at issue to the complainant. The ACCPA also prohibits bad faith registration of domain names that conflict with a trademark owner’s rights. A suit brought under the ACCPA is filed in federal court and provides remedies unavailable in a UDRP proceeding such as allowing for discovery, injunctive relief and monetary damages. An ACCPA claim against a “.com” domain name may be brought in

federal court in Virginia even if the owner of the domain name is in a foreign jurisdiction—a significant advantage in pursuing foreign infringers. The costs associated with an ACCPA claim tend to be significantly higher than an arbitration brought under the UDRP, and ACCPA cases usually take longer to resolve. As this cursory comparison shows, both the UDRP the ACCPA have advantages and drawbacks, and consideration should be given to which will best serve the needs of a trademark owner in a particular situation.

Another tool available to trademark owners to combat infringing domain names is the more recently introduced “Uniform Rapid Suspension” (“URS”), also administered by ICANN. A URS proceeding is seen as a more streamlined, less expensive alternative to a UDRP proceeding. A URS proceeding provides only for suspension—rather than transfer—of the unauthorized domain name. Moreover, URS proceedings are available only for TLDs introduced after 2012 and are not applicable, for example, to domain names registered under the .com TLD.

#### **D. Risks of Failure to Enforce**

A franchisor must police its brand and maintain quality control to ensure the continued protection of its principal trademarks, trade secrets, and other proprietary information. If a franchisor fails to do so, then it may lose its rights in its mark by abandonment or its rights in its trade secrets by disclosure. In addition, failing to act to stop infringing conduct or improper competition in one instance could allow future infringers to argue waiver or lack of irreparable harm.

For example, if a franchisee begins using the franchisor’s principal trademark in connection with unauthorized goods or services and the franchisor does nothing, the franchisee may be deemed to have obtained a “naked license.” Under the Lanham Act, a mark may be deemed abandoned “[w]hen any course of conduct of the owner, including acts of omission as well as commission, causes the mark to become the generic name or otherwise lose its significance as a mark.”<sup>190</sup> Federal courts have deemed a mark abandoned based on licensing with inadequate quality controls.<sup>191</sup>

Trademark owners are required to use reasonable business efforts to police unauthorized and improper uses of their marks, and they may use reasonable business judgment in determining which infringements to pursue. The risk of unauthorized use is that a mark either will be accorded an increasingly narrow scope of protection as similar marks encroach on and weaken its distinctiveness, harming the brand and the goodwill associated with it or, in extreme cases, causing the mark to cease functioning as a source indicator entirely. Thus, while a trademark owner is not required to search out and stop all cases of infringement, it cannot disregard infringing uses that come to its attention during its normal business activities.

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<sup>190</sup> 15 U.S.C. § 1127.

<sup>191</sup> See, e.g., *FreecycleSunnyvale v. Freecycle Network*, 626 F.3d 509, 515 (9th Cir. 2010).

In addition, failure to protect the confidentiality of trade secrets can result in loss of protection for such purported trade secrets.<sup>192</sup> As noted above, information must be “secret” in order to constitute a trade secret and a franchisor must make reasonable efforts to maintain the confidentiality of such information. Allowing former franchisees or other third parties to possess and use the franchisor’s trade secrets risks the argument that the information is no longer secret and therefore no longer protectable as trade secrets.

## **VII. CONCLUSION**

Prudent franchisors maintain an updated intellectual property plan spanning all of their sundry property interests and license agreements. They docket due dates or work closely with outside intellectual property counsel to manage registrations and renewals. Further, they review their intellectual property portfolio annually when they conduct their financial audit and franchise registration renewals and confirm that their current use aligns with any development plans. And finally, they include an intellectual property review as part of their renewal process for franchise agreements. They check that the franchisees are compliant with directives regarding notices and proper use of all intellectual property and that the franchise is on brand for the next term.

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<sup>192</sup> Cf. *Motor City Bagels, L.L.C. v. Am. Bagel Co.*, 50 F. Supp. 2d 460, 480 (D. Md. 1999) (finding no trade secret protections where the “plaintiffs simply did not act reasonably in seeking to ensure the secrecy of their plan”); *McAlpine v. AAMCO Automatic Transmissions, Inc.*, 461 F. Supp. 1232, 1256 (E.D. Mich. 1978) (“The subject of a trade secret must be secret, and must not be part of the public knowledge or of general knowledge in the trade or business involved.”).