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Basics Track: Trademarks & IP

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Fundamentally, franchising is a system of licensing intellectual property. Because of that, it is essential that all franchise lawyers understand the basics of intellectual property law, including how to establish and enforce rights in the various types of intellectual property. This paper (and its corresponding session) aims to provide a roadmap for attorneys unfamiliar with this area of the law. First, Section I discusses the basic types of intellectual property. Section II summarizes the role of intellectual property in franchising. Finally, Section III discusses various enforcement strategies and how they might impact a franchised brand.

I. The Basic Types of Intellectual Property

Intellectual property is distinct from other types of property in that it is intangible. It includes things like music, designs, names, images, confidential business information, art, and branding. Most businesses rely on some form of intellectual property. In franchising, intellectual property is often the core of the business as what the franchisor offers the franchisees are the intangible assets of trademarks, trade dress, and trade secrets and other confidential information. There are four fundamental categories of intellectual property discussed below: (1) trademarks, (2) trade secrets, (3) copyrights, and (4) patents.

A. Trademarks

Trademarks are the intellectual property at the heart of every franchise. They identify the brand and the products and services offered by it. Even the Federal Trade Commission's ("FTC") definition of "franchise" specifically includes the licensing of a franchisor's trademark to the franchisee as an essential element.[1]

A trademark is a term, symbol, design, slogan, packaging, sound, or smell (or some combination of these elements) that identifies a product or service as coming from a single source.[2] Trademarks identify and distinguish a business's goods and services to the public and therefore serve a commercial purpose. Technically, trademarks identify products, and service marks identify services. But the general term "trademark" or "mark" is commonly used to refer to both trademarks and service marks.

Trade dress refers to packaging or overall presentation of a product or aspect of a business, and it is considered a type of trademark. It includes the non-functional size, shape, color, or product design (or some combination of these) that distinguishes one source from another.

A trade name is the name under which a business operates. It may be a corporate name, the name of a limited partnership, the names of partners in a general

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[1] 16 C.F.R. § 436.1(h)(1).
[2] *See* 15 U.S.C. § 1127.

partnership, or a different name altogether.[3] A trade name is different from a trademark—but sometimes the same word or phrase serves both functions.

Because of the importance of trademarks to commerce, federal and state governments of the United States have taken steps to recognize and protect trademark rights. These protections are designed to prevent unfair competition. Businesses invest in building their brand and reputation with the public and getting consumers to recognize their products and services. Trademark protection prevents other businesses from thwarting or free riding on that effort, and it prevents consumer confusion.

1. Selecting a Protectable Mark

Strong trademarks—those which are most easily protected—are inherently distinctive. That is to say, they readily identify a recognized source. Coined marks (made up words) and arbitrary marks (words that have a meaning but not in the context in which they are being used as trademarks) are generally inherently distinctive as they do not in and of themselves tell you about the product, and they have no connection to the underlying goods and services. Similarly, marks that give a suggestion or hint about the product or service (but do not describe it) are treated as inherently distinctive "suggestive" marks. This is because they require imagination or thought to connect the mark to the products or services.

On the other hand, generic words and descriptive marks are weak marks. These may not be protected at all. Generic words are the commonplace names for things. These are not protectable as they must remain available for use by others. Descriptive marks tell a consumer about the quality, characteristics, or use of the product or service they identify. Laudatory marks, which signal that the product or service is of high quality, are considered descriptive marks. Descriptive marks also include terms that signal geographic origin of the product or services, family names, and surnames. Unless they have acquired a source-identifying function beyond the descriptive meaning, descriptive marks may not be protected. However, descriptive terms can sometimes "acquire distinctiveness" and gain trademark protection. Generally this would be accomplished through a significant marketing effort to connect a generic word with a specific source.

Experts can and do debate whether a mark is descriptive or suggestive. Thus, exactly where any particular mark falls on the continuum of protection is subject to differing opinions and can even change over time. For example, a coined mark created from a once non-existent word to identify a product or service may have no generic meaning when adopted. But, over time that new word may become the generic word for that product or service—e.g., Aspirin, escalator, kerosene, and thermos were once all coined marks. Over time and through usage, these marks and other coined marks

[3] If the trade name is different from the formal name of the business, most states require filing as an assumed name or fictitious business name in the relevant state or county.

have become the generic word for the type of products offered rather than identifying the specific source of the products. Thus, they are no longer protectable trademarks.

In addition to descriptive marks, other marks that may not be protected are those that falsely suggest a connection to an unrelated source; include the flag of any nation; or include the name, likeness, or signature of a living person without that person's consent.

After tentative selection of a proposed trademark, the next step is to determine whether it is likely to infringe on someone's prior rights in the mark or goodwill. Selecting an infringing mark could result in numerous problems down the road, including being forced to stop using the mark and to pay damages. In addition, the business could lose all its investment in the infringing mark such as any goodwill the mark had developed.

Because of this, selecting a trademark generally involves an investigation to identify existing uses plus an analysis of any existing uses found (a "knock-out search"). This work typically involves an attorney who can evaluate whether or not the existing uses are "confusingly similar" to the proposed mark. The attorney will search the United States Patent and Trademark Office ("USPTO") database for all applications and registrations bearing a similarity to the proposed marks, as well as social media databases, common law databases, entity name registrations, and state trademark registrations. Performing a trademark search early on (and in particular, before attempting to register the mark) will allow an attorney to identify potential obstacles, structure the application, and adjust the mark as necessary to avoid obstacles in the registration process. Specifically, the standard to consider in selecting a trademark is whether the mark is likely to cause confusion, mistake, or deception with regard to source, sponsorship, or affiliation with prior rights. If it does, the proposed mark is most likely infringing upon another business's trademark and should be avoided.

2. Common Law Trademarks

Common law trademark rights arise through the use of a mark capable of protection in commerce. As discussed above, this requires the use of a non-descriptive mark in connection with a good or service. The use in commerce must be more than casual, sporadic, or *de minimis* use, and it must be prior to any other current user.

A common law trademark will not arise if the mark merely describes the goods or services being offered or is a generic name for them.[4] Rather, the mark must be suggestive, arbitrary, or fanciful when applied to specific goods or services—that is to say, it must serve as a distinct "source indicator." In addition to distinct use in connection with a good or service, a trademark needs to be used prior to any other current users. The legal principle "first in time, first in right" generally applies to trademark rights in the United States.

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[4] *See id.* § 1052(e).

Generally, once (i) first or prior use (ii) of a non-generic and non-descriptive mark (iii) in connection with goods or services (iv) in commerce are established, the business has the exclusive right to use the trademark in a particular area, meaning it can prevent others in that same area from using the mark or any other trademark that creates a likelihood of confusion. The importance of the "same area" cannot be overstated. If a trademark owner only uses and advertises a mark in a specific region, the trademark rights and protections only exist in that area and the "likely zone of expansion" surrounding it. That means someone else might be able to use the mark with impunity in another part of the country even in the same or a similar business.

3. Trademark Registration

While trademark rights in the United States arise from use, marks can be registered both federally and within a particular state for additional protections. Federal registration in the USPTO on the Principal Register provides several benefits for marks used nationally or across state lines. These registered marks have:

- the presumption of ownership, validity of the mark, and the exclusive right to use the mark in connection with the product or service for which it is registered.[5]

- constructive notice of a claim of ownership nationwide.[6] This may be used against others who later adopt the mark.

- the right to seek "incontestable" status, which eliminates many grounds for challenge of the mark after five years of registration.[7]

- registration on the Principal Register allowing trademark owners to file trademark infringement claims in federal court under the Lanham Act, which is the federal statute providing for trademark protection.[8] This gives the owner access to certain statutory remedies for trademark infringement.[9]

In addition, registration with the USPTO can create rights without use. For example, registered marks give the owner rights without use in the United States based

[5] *See id.* § 1057(b).
[6] *See id.* § 1072.
[7] *See id*. § 1065. During the sixth year following federal trademark registration, a statement of continued use must be filed to keep the registration in force.
[8] *See id.* § 1051, *et seq.*
[9] *See id*. § 1114.

upon applications and registrations in foreign countries.[10] Owners may also reserve a mark that has not yet been used based on an intent to use the mark.[11]

Obtaining a federal registration requires an application to the USPTO. In the application, the applicant must state whether the business currently uses the mark in interstate commerce or intends to use the mark at a later time.[12] The business will have to provide proof of actual use in connection with the goods or services.

After the application is submitted, an examiner will evaluate the mark to determine if it has met the necessary elements for registration. Specifically, the examiner will look at whether the mark is distinct enough to warrant trademark protection or if it is descriptive or generic. As part of the application process, the examiner will also search the USPTO database to determine whether the proposed trademark would create a likelihood of confusion (for example, due to the similarity in appearance, sound, commercial impression, and underlying services) with any other registered trademark.[13] Registrations can also be refused if a mark is immoral or scandalous, is a surname, or is a geographic mark.[14] And deficiencies can arise related to more procedural issues, such as failure to include the consent of a living individual a specific mark identifies or failure to include a "specimen" (evidence showing use of the mark in connection with the goods or services).

If an examiner believes that a mark cannot be registered for one of these (or other) reasons, the examiner will generally issue an "office action," setting forth the grounds for rejection or issues with the application. The applicant will have the opportunity to respond.[15] If the examiner states that the mark presents a likelihood of confusion with another registered trademark, then the applicant can attempt to show that no likelihood of confusion exists. Alternately, the applicant can reach out to the owner of the registered mark and obtain a consent agreement in which the parties can define the scope of their respective uses and agree that the marks pose no likelihood of confusion.[16]

Marks that are merely descriptive will be denied registration on the Principal Register, but they can be registered on the "Supplemental" Register.[17] If a mark is registered on the Supplemental Register and then acquires distinctiveness, the owner

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[10] *See id*. § 1126.
[11] If the intent is only to use a mark in a single state, then federal trademark registration is precluded.
[12] *See id*. § 1051.
[13] *See id.* § 1052(d).
[14] *See id.* § 1052(a).
[15] *See id*. § 1062(b).
[16] *See id*. § 1052(d).
[17] *See id*. § 1091. The Principal Register is only for suggestive or arbitrary/fanciful marks. The Supplemental Register confers few rights. Generic marks cannot be registered on the Supplemental Register.

must submit a new application for registration on the Principal Register, which will be based in part on the previous, supplemental registration. Five years of consistent use of a mark capable of acquiring distinctiveness and registered on the Supplemental Register will provide the presumption of acquired distinctiveness.[18] In the interim, the mark will be afforded much less protection on the Supplemental Register than those on the Principal Register.

Trademark owners also have the ability to challenge applications for trademarks. If an examiner approves an application, notice of the application will be published in the USPTO gazette. Any party who believes it has superior rights in the mark can oppose the registration of the mark within 30 days of publication.[19] Because of this, it is essential that trademark owners pay attention to the publication and use of other marks, as the registration of a confusingly similar mark could pose significant problems for a trademark owner in the future.

A party with superior rights may petition to cancel a federal trademark registration of another party for a period of five years.[20] After that, a registration becomes “incontestable” (if the owner has filed the required notice and proven to the USPTO that the mark is still in use).[21] A federal trademark registration has a 10-year term. Registrations may be renewed repeatedly if the mark is still in use for the listed goods or services. If properly used and protected, trademark rights can last indefinitely. However, a registration may be canceled at any time based on the mark becoming generic, abandonment, or fraud.[22]

In addition, states also provide for trademark registration.[23] State registration is not necessary if a mark is federally registered, but it can be beneficial if a mark is only used locally or is otherwise not capable of federal trademark 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 may also provide additional remedies not otherwise available at common law.[24] Most states require that a mark be in use before an application is filed. Most state registrations have a 10-year term.

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[18] *See id.* § 1065.
[19] *See id*. § 1063(a).
[20] *See id.* § 1064(1).
[21] *See id.* §§ 1065, 1058. This required notice and proof of use are a notice and an affidavit, respectively.
[22] *See id.* § 1064(3).
[23] The Model State Trademark Bill (2007) has strongly influenced most modern state trademark statutes.
[24] *See*, *e.g.*, International Trademark Association, *Model State Trademark Bill* § 14 (last visited Apr. 21, 2017), http://www.inta.org/Advocacy/Pages/ModelLawsandGuidelines.aspx.

Internationally, trademark rights arise from registration rather than use. Trademark rights generally are protected on a country-by-country basis. Thus, businesses operating on a multinational basis must analyze the costs and benefits of obtaining registration covering each country in which they desire protection of their marks. Notably, the European Community has adopted a single trademark registration, called a "Community Trademark," which covers all its member states. This registration is available in addition to national registration in the member states. Also, because of the Madrid Protocol treaty, applicants from the United States may make one trademark filing in the United States for international registration in the United States and designated member countries of the treaty. The international protection of trademarks is discussed in more detail in Section I.A.6 below.

4. Proper Use of Trademarks

Properly using a trademark is essential to preserving rights in that mark. One key aspect of proper use is notice. A trademark notice informs others of rights in trademark and might discourage them from adopting a similar or infringing mark. Trademark notice is not mandatory, and it does not need to appear with every use of the mark. However, the notices should be used often enough to notify others, specifically the relevant market, of trademark rights.

There are several mechanisms for providing appropriate trademark notice in the United States. For trademarks registered with the USPTO, the "®" symbol is the most common form of notice. [25] "Registered in U.S. Patent and Trademark Office" and "Reg. U.S. Pat. & Tm. Off." are also acceptable for federally registered marks. Importantly, these notices may not be used unless a certificate of registration has been issued for the mark. If the owner of a federally registered mark fails to use one of these forms of trademark notice, no profits or damages may be awarded in a trademark infringement case unless the defendant had actual notice of the registration.

In the United States, trademarks that are not registered with the USPTO may use the designation "TM" for trademarks and service marks or "SM" for service marks. SM is an informal designation with no legal status.

There is no general rule of thumb for marks outside of the United States as each jurisdiction has its own requirements for proper trademark notice.

In addition to providing notice, some best practices for proper use of trademarks include:

- Treating trademarks that are words or terms as adjectives, rather than nouns or verbs.

- Using the mark consistently and without modifications.

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[25] *See* 15 U.S.C. § 1111.

- Making the mark stand out from surrounding text (such as through use of capital letters, bold print, color, or italics).

- Using a common or generic word after the trademark to prevent it from becoming the generic word for the product or service.

- Refraining from making a trademark plural by adding "s" (instead make the common or generic word after the mark plural).

- Avoiding the addition of endings or punctuation to the trademark (such as "ing" or "ed").

5. Trademark Infringement

The owner of a trademark may bring a trademark infringement claim against a subsequent user of a "confusingly similar" mark. Whether a mark is confusingly similar is a question of fact based on the following factors: (i) the similarity of the overall impression of the marks, encompassing their look, sound, or meaning; (ii) the similarity of the underlying goods and services; (iii) the strength or weakness of the plaintiff's mark (that is, the distinctiveness of plaintiff's mark); (iv) any evidence of actual confusion by consumers; (v) the defendant's intent in adopting the mark; (vi) the proximity of goods in the retail marketplace (such a similarity of trade channels or overlap of customers); (vii) the degree of care exercised by the consumer (for example, are the consumers sophisticated or are the purchases impulse buys); and (viii) the likelihood of expanding the lines of goods and services.[26]

"Fair use" can be a defense to a claim of trademark infringement. This includes "classic fair use" where the alleged infringer has used another's mark as a descriptive term and "nominative fair use" 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. And 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) are also available.

If trademark infringement is found, the infringer may be ordered to stop using the mark. For claims brought under the federal Lanham Act, an infringing defendant may be ordered to pay the trademark owner's actual damages or treble damages; 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.

Trademark owners are required to use reasonable business efforts to police unauthorized and improper uses of their marks, and they may use reasonable business

[26] *See AMF Inc. v. Sleekcraft Boats,* 599 F.2d 341, 348-49 (9th Cir. 1979).

judgment in determining which infringements to pursue. In addition to the harm to the brand and the owner's goodwill associated with the mark, the risk of unauthorized use is that a mark will cease to serve a source-identification function. 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.

6. International Protection for Trademarks

With the global economy and the ever increasing ease of communication worldwide, international trademark protection has become an essential part of any brand's strategy. The vast majority of countries define a trademark as a sign that is capable of distinguishing the goods and services of one person from those of another.[27] Although trademark protection still remains somewhat of a patchwork system, developments that harmonize multinational procedures and rights now allow for more efficient and cost-effective strategies.

The importance of a distinctive mark is universal; thus, that factor remains important in selecting a mark that will be used internationally. Other considerations arise though. International or potentially international marks must be carefully evaluated from a practical perspective. For example, it is critical to evaluate whether the mark's translation or transliteration has a negative or offensive meaning. Additionally, it is important to consider whether a proposed mark is even registerable in countries of interest. Some countries have unique registration requirements. Some explicitly forbid registration of single letters or numbers while others make it impossible to register common words without evidence of prolonged use, significant advertising, and consumer recognition. The law becomes even more elusive when discussing registrability of non-traditional marks such as sounds, scents, tastes, motions, gestures, colors, and designs. Some countries allow registration; others are silent on the issue; and still others expressly prohibit such registrations. Even countries that allow all types of non-traditional marks may require strong evidence of acquired distinctiveness or limit registrability in some other way.

In light of all of this, registration of a trademark internationally can be a time intensive and costly process. The questions of when and where to register are incredibly important. While it is easy to justify registration in countries where the business's products or services are offered, it may be equally important to defensively file applications in other countries to preclude others from obtaining rights to your brand. This is particularly true as many countries are first to file jurisdictions—that is, they prioritize trademark rights based on the filing date rather than use—and others offer little or no protection for unregistered marks.

[27] Although many countries have recognized services, some only allow protection for goods. Often, there are workarounds in these countries, such as seeking protection for goods such as advertising material for services to cover a services component.

The seemingly straightforward answer to all of these issues is to register your mark in each country. This is generally cost prohibitive. But, franchisors can and should utilize agreements and treaties to coordinate filings and reduce costs. There are numerous international agreements that coordinate the procedure for filing and grant protection covering multiple countries. For example, trademark registration with the Benelux Office of Intellectual Property grants rights in Belgium, Luxembourg, and the Netherlands. Community Trade Marks registered with the Office For Harmonization in the Internal Market grants protection for all EU member states via a single registration. International Registration under the Madrid System covers multiple member countries. Registration with the African Intellectual Property Organization allows the mark to cover all its member countries in Africa. Even further regionalized, the African Regional Industrial Property Organization protects a trademark registration in member states in South Africa.

In addition, trademark owners can and should take advantage of international treaties that afford similar rights, protections, and harmonize various laws. The oldest such treaty, the Paris Convention For the Protection of Industrial Property, allows nationals of any signatory country to enjoy the advantage that their national law grants in all other signatory countries. It further allows an applicant in one signatory country to obtain the filing date in its home country (for priority) for applications filed within six months in other signatory countries. Finally, the Paris Convention allows for protection of well-known marks, protection of trade names, and claims of unfair competition.

Finally, the Madrid System, comprised of the Madrid Agreement and the Madrid Protocol, provide a mechanism for trademark registration. The Madrid Agreement allows any trademark applicant of a signatory country to file an application for an International Registration either directly with its national or regional trademark office or with the International Bureau of the World Intellectual Property Organization. The Madrid Protocol enhances aspects of the Madrid Agreement by, for example, allowing an International Registration application to be based on a pending application filed in an applicant's home country.

B. Trade Secrets

The underlying processes and methods that make up the operational aspects of a franchised business—its trade secrets—are just as critical as the trademarks. These processes and methods have significant value only if they are not known to the public or to competitors. Both state and now federal law recognize and protect these confidential methods and knowledge if they rise to the level of "trade secrets."

The Uniform Trade Secrets Act (the "UTSA") provides the general framework for protecting trade secrets. It was written in an effort to harmonize the laws of the states.[28]

[28] *See generally* National Conference of Commissioners on Uniform State Laws, *Uniform Trade Secrets Act with 1985 Amendments* (Feb. 11, 1986), http://www.uniformlaws.org/shared/docs/trade%20secrets/utsa_final_85.pdf (hereinafter "UTSA").

All states have adopted the UTSA, except for New York, Massachusetts, and North Carolina.[29]

1. Elements of a Trade Secret

The UTSA defines a "trade secret" as:

> information, including a formula, pattern, compilation, program, device, method, technique, or process, that:
>
> > (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and
> >
> > (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.[30]

Both elements are important. The first—independent economic value from not being generally known—should appear naturally in most successful franchises.

The second element—reasonable efforts to maintain secrecy—requires constant care and attention because trade secrets will lose their protection if they become generally known. Typically businesses employ measures such as restrictions on the disclosure of trade secrets to only "need to know" employees, confidentiality agreements, restrictive covenants, and physically preventing access (such as maintaining information in a vault) to protect their trade secrets.

Franchising presents unique challenges in this regard as sharing and replicating trade secrets business to business is the cornerstone of the model. In franchised businesses one key way to protect trade secrets is through the franchise agreement. Confidentiality covenants, restrictive covenants against competition, and inclusive and accurate definitions of "confidential information," which fully capture and protect those aspects of the franchisor's system that "derive independent economic value" from "not being readily ascertainable" are critical. The confidentiality requirements should capture all parties associated with each franchisee who may have access to such confidential information, including managers, owners, shareholders, and family members. Since trade secrets and confidential information may encompass some of the franchise's most valuable assets, care must be taken to ensure that appropriate measures are in place

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[29] *See* National Conference of Commissioners on Uniform State Laws, *Acts: Trade Secrets Act (last visited Apr. 21, 2017)*, *http://www.uniformlaws.org/Act.aspx?title=trade%20Secrets%20Act* (the UTSA has been introduced in New York and Massachusetts).

[30] UTSA § 1(4).

so that the confidential nature of such information will be upheld and enforced by the courts.

2. Misappropriation of Trade Secrets

The UTSA provides for injunctive relief for any actual or threatened misappropriation of trade secrets.[31] It allows for damages in the amount of the actual loss caused by misappropriation and the unjust enrichment of the misappropriating party, and it further provides for double damages and attorneys' fees in cases of willful and malicious misappropriation.[32] If the misappropriating party obtains an economic windfall based on misappropriated trade secrets, an action under the UTSA will generally require that party to disgorge its profits.[33] Because misappropriation of trade secret cases are often complex, experts are generally required to calculate damages and describe the industry's knowledge of the alleged trade secrets.

The UTSA defines "misappropriation" broadly as:

> (i) 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
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> (ii) disclosure or use of a trade secret of another without express or implied consent by a person who
>
>> (A) used improper means to acquire knowledge of the trade secret; or
>>
>> (B) at the time of disclosure or use, knew or had reason to know that his knowledge of the trade secret was
>>
>>> (I) derived from or through a person who had utilized improper means to acquire it;
>>>
>>> (II) acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or
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>>> (III) derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or

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31 *See id.* § 2(a).
32 *See id.* § 3.
33 *See id.* § 3(a).

> (C) before a material change of his [or her] position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.[34]

The definition repeatedly uses the term "improper means," which in turn is defined to include "theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, or espionage through electronic or other means[.]"[35] Thus, improper means are actions that generally fall outside of typical business activity and competition.

3. Federal Protection for Trade Secrets

On May 11, 2016, the federal Defend Trade Secrets Act ("DTSA") took effect, creating new federal protections for trade secrets.[36] The DTSA creates a federal cause of action for trade secret misappropriation. Specifically, it provides a private right of action for misappropriation of a trade secret that is related to a product or service used in, or intended for use in, interstate or foreign commerce. Trade secret owners can therefore now pursue their claims of misappropriation directly in federal court without any other basis for federal jurisdiction rather than only having access to state courts. The DTSA does not preempt existing state trade secret laws, so businesses still have the option to bring trade secret cases in state court under state law (and obtain the benefit of a well-developed body of case precedent).

The DTSA also provides protections to whistleblowers from accusations of trade secret misappropriation. Employers are required to provide notice of these protections to their employees in any document that discusses their policies concerning employee use of trade secrets or other confidential information. The notice can be provided to employees by incorporating specific language from the DTSA into all the required documents or by issuing a policy for reporting suspected violations of the law that complies with the DTSA and then cross-referencing that policy in the documents.

Finally, the DTSA provides a new tool for businesses to act quickly to prevent the dissemination of their trade secrets by giving federal courts the power to order a seizure of property on an *ex parte* basis. This provision is designed to prevent dissemination of trade secrets.

4. International Protection for Trade Secrets

Trade secrets and confidential information are perhaps the most difficult form of intellectual property to protect internationally. The common practice of using non-competition covenants to protect them is often counter to local policies on the use of such covenants. And, unlike the United States, many jurisdictions do not distinguish

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[34] *Id.* § 1(2).
[35] *Id*. § 1(1).
[36] Defend Trade Secrets Act of 2016, S. 1890, 114th Cong. (2016).

between trade secrets, which are sometimes more focused on technical information, and confidential information such as customer lists.

There is no uniform legal theory internationally as to the basis for trade secret law. In some jurisdictions, such as Canada, trade secrets are based on relational obligations such as contract, employment status, or fiduciary duty. In the United States however the concept of a trade secret is based on property rights. Other countries base trade secret protection on fairness and equity, unfair competition law, or tort.

The effectiveness of trade secret protection varies primarily with the nature of the legal system in each country. There are many more civil law jurisdictions in the world than common law jurisdictions, and almost uniformly civil law jurisdictions do not have pre-trial discovery or depositions, rendering the protection of trade secrets and confidential information more difficult. Generally speaking, civil law jurisdictions require written records that are carefully recorded and verified from the start of the transaction. There are other areas where policy differences between jurisdictions lead to variations in the enforcement of the protection of trade secrets—for example, in the enforceability of confidentiality agreements and non-competition covenants. Given this, businesses are advised to maintain meticulous records and to start their system of international protection with non-disclosure agreements that are narrow and tailored to the target jurisdiction.

C. Copyrights

Copyrights are typically not as prominent in franchised businesses as trademarks and trade secrets, but they provide important protections that should be understood. Copyrights are the federal statutory rights of an "original works of authorship fixed in any tangible medium of expression," protected under the Copyright Act.[37] The Copyright Act identifies six specific rights that are exclusive to the copyright owner: (1) reproduction, (2) preparing derivative works, (3) distribution, (4-5) performance of sound recordings or other works, and (6) display.[38] Not all rights will be relevant to each type of work. The Copyright Act provides copyright owners the ability to bring a claim based on infringement of these rights, and it preempts state and common law.[39]

Copyrights, then, depend on understanding two concepts—"works of authorship" and a "tangible medium of expression." The Copyright Act defines "works of authorship" as: (i) literary works; (ii) musical works; (iii) dramatic works; (iv) pantomimes and choreographic works; (v) pictorial, graphic, and sculptural works; (vi) motion picture and other audiovisual works; (vii) sound records; and (viii) architectural works.[40] These types of work encompass franchise manuals, photos and videos, internet websites,

[37] 17 U.S.C. § 102(a).
[38] *See id.* § 106.
[39] *See id.* § 501.
[40] *Id.* § 102(a).

commercials and advertising, and more. Copyrights can even protect certain computer programs and software.[41]

A "tangible medium of expression" can be anything from a writing on a piece of paper, paint on canvas, audio or visual recording, a publication online, or anything else from which the work can be perceived and reproduced.[42] The delivery of a speech or performance that was not recorded would not be "fixed" and is not protected by copyright, although the written script may be protected.

Certain functional things are not covered by copyright. Ideas, concepts, discoveries, procedures and methods of operation are not protected by copyright, although some may fall within the realm of patent law. Icons, logos, titles, and short phrases are not deemed to have sufficient originality to gain copyright protection, but may serve as trademarks. Useful items such as clothing cannot be protected, although an original design on fabric may be. Lastly, factual compilations such as directories and telephone books are not subject to copyright protection (but the original selection or arrangement of unoriginal facts might be protectable).

Copyright protection is limited in duration, generally only lasting for the life of the author plus an additional 70 years.[43] For works created by more than one author, copyright protection lasts for 70 years after the death of the last surviving author.[44] Copyrights on works made for hire (or cases where the author is an entity) last for 95 years from the year of the work's first publication or 120 years from the date of creation, whichever expires first.[45]

Use of copyright notice is not required to preserve copyright in a work for works first published in the United States after 1989. However, copyright notice is suggested in the following form: "© [year] [copyright owner]".

1. "Common Law" Copyrights and Works for Hire

An original work of authorship gains copyright protection under the Copyright Act as soon as it is fixed in a tangible medium of expression. The author of the work is the owner, and the owner can assign all or partial rights in a work. The author does not need to register the mark or take any additional action in order to obtain rights in the work. However, the United States Copyright Office has a system for registering copyrights.[46] If the owner of a copyright wishes to bring a lawsuit for copyright

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[41] This may provide an extra layer of protection for a franchisor licensing proprietary software to its franchisees.
[42] *See id.*
[43] *Id.* § 302(a).
[44] *Id.* § 302(b).
[45] *Id.* § 302(c).
[46] *See* U.S. Copyright Office, *Registration Portal* (last visited Apr. 21, 2017), https://copyright.gov/registration/.

infringement, then the owner must register the work prior to bringing a claim.[47] Registration also confers other benefits like the ability to recover statutory damages and attorneys' fees.[48]

A "work for hire" arises when an employee or someone under contract creates something capable of copyright protection, and, by virtue of the employment or contract, a copyright in the material inures to the employer or contracting party.[49] This doctrine applies only to employees, not to independent contractors or suppliers. Works created by independent contractors typically are owned by the author, even if another person or entity paid for the work, unless the parties execute a written assignment. Franchise agreements should contain a "work for hire" clause granting the franchisor ownership of anything created by the franchisee or its employees while operating as a franchisee. These provisions should be drafted broadly to cover not only copyrights, but also other developments that could constitute any other form of intellectual property.

2. Copyright Infringement

Copyright infringement occurs when one of the exclusive rights under the Copyright Act is used without authorization of the owner.[50] For example, the unauthorized copying of a franchise manual or the unauthorized use of an advertisement might be copyright infringement. Infringement may also occur by circumventing the controls on an e-book or altering the copyright notice and credit information. While it can be difficult to prove direct copying, copying can be inferred from (i) the substantial similarity of the allegedly infringing work to the plaintiff's work, and (ii) the alleged infringer's access to the plaintiff's work. Intent is not required. This means it is possible in theory to have two different authors create identical original works, both of which would be subject to copyright protection without infringing the other's rights.

As noted above, copyright registration is required before a suit for copyright infringement may be filed in the United States. Further, registration within 90 days of publication can provide advantages to the copyright owner in litigation.

There are numerous defenses to copyright infringement, including "fair use" of the copyrighted material. The "fair use" defense to infringement claims may apply if portions of the work are used for comment, news reporting, teaching, research, criticism, and scholarship. Courts apply a balancing test to determine whether or not such use is "fair."[51] To do so, they will weigh the following factors:

[47] *See* 17 U.S.C. § 411(a).
[48] *See id.* § 412.
[49] *See id.* § 101.
[50] *See id.* § 501.
[51] *See id.* § 107.

- The purpose and character of the use, including whether the use is of commercial nature or is for nonprofit educational purposes;

- The nature of the copyrighted work;

- The amount and substantiality of the portion used in relation to the copyrighted work as a whole; and

- The effect of the use upon the potential market for, or value of, the copyrighted work.

Many courts have grappled with application of the fair use factors, yielding many different results.

Copyrighted material may also be fairly used for parody in certain circumstances.[52] And there are other narrow exceptions for libraries, classroom teaching, and certain transmissions. Finally, an alleged infringer can invoke equitable defenses and other common defenses, such as laches, existence of an implied license, or failure to bring a claim within the applicable statute of limitations.

If copyright infringement is found, the infringer may be ordered to stop using the copyrighted material. A court may also order the infringer to pay either the actual damages to the owner and the infringer's profits or presumed "statutory" damages. Statutory damages can range from $750 to $30,000, or up to $150,000 for willful infringement. The court also may award attorneys' fees to the prevailing party.

3. International Protection for Copyrights

Copyrights generally have international protection almost automatically through the participation of many countries in treaties. This can be a significant advantage for businesses expanding internationally, as theoretically no registration is required and the coverage spreads quickly. The two original treaties that extended copyright protection to most countries internationally are the Berne Convention for the Protection of Literary and Artistic Works,[53] (the "Berne Convention") first signed in 1886 and the Universal Copyright Convention,[54] (the "UCC") adopted in 1952. The Berne Convention provides (among other things) that nationals of one member country are entitled to the same

[52] *See*, *e.g.*, *Broadcast Music, Inc. v. McDade & Sons, Inc.*, 928 F. Supp. 2d 1120, 1131 (D. Ariz. 2013).

[53] *See generally* World Intellectual Property Organization, *Berne Convention for the Protection of Literary and Artistic Works* (last amended Sept. 28, 1979), http://www.wipo.int/treaties/en/text.jsp?file_id=283698.

[54] *See generally* World Intellectual Property Organization, *Universal Copyright Convention of 6 September 1952, with Appendix Declaration relating to Article XVII and Resolution concerning Article XI* (Sept. 16, 1955), http://www.wipo.int/wipolex/en/other_treaties/details.jsp?treaty_id=208.

copyright protection in another member country as a national of that other member country would receive. The United States changed its copyright law substantially in 1989 and became a party to the Berne Convention as well as the UCC. While these treaties are still relevant in technical applications for recognitions in foreign courts, the general provisions have since been replaced by the Agreement on Trade-Related Aspects of Intellectual Property that is a requirement for membership in the World Trade Organization.[55]

Many franchisors think that reliance on these treaties is sufficient copyright protection, but that reliance may be misplaced. The actual protections afforded depend on conformity to local requirements. For example, proving ownership of a copyright in many foreign courts requires clear written evidence of the chain of title from the creator to the current owner. This evidence can be voluminous, and in civil law jurisdictions it will often be necessary to have the evidence notarized and legalized. Further, different jurisdictions have different ways of categorizing the employment and commissioned works relationships, so a transfer agreement that satisfies a court in the United States may not be appropriately worded for the registrar in other nations. Also, concepts such as “work for hire” can be difficult to explain in a foreign court. So proving chain of title can be a costly and lengthy process.

The two main items that franchisors usually wish to protect are the artistic work in their logos and the operations manual. Logos present a challenge because some jurisdictions require that the work demonstrates a minimum level of creativity. For example, in the United States the Copyright Office declines to register the copyright in logos because it has determined that they do not contain enough creativity.[56] But in Canada, the case law is clear that there is copyright in logos and that it is protectable.[57]

Similarly, while operations manuals generally contain enough creativity for protection, in some jurisdictions problems arise regarding the transfer of ownership in these works. To satisfy the requirements of some foreign courts or registrars, the franchisor will be required to identify each person who worked on the manual and their relationship to the franchisor. These details can be hard to come by for United States franchisors, who may not routinely keep such records.

D. Patents

Like copyrights, patents do not appear frequently in franchising. Perhaps the best advice to any franchise lawyer when encountering a patent law issue is: hire an expert. Still, some familiarity with this type of intellectual property is useful.

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[55] *See generally* World Trade Organization, *Agreement on Trade-Related Aspects of Intellectual Property* (last visited Apr. 21, 2017), https://www.wto.org/english/docs_e/legal_e/27-trips.pdf.

[56] *See* U.S. Copyright Office, *What Does Copyright Protect?* (last visited Apr. 21, 2017) http://www.copyright.gov/help/faq/faq-protect.html.

[57] *See generally Canadian Ltd. v. Law Soc’y of Upper Can.*, 2004 S.C.C. 13 [2004].

1. Types of Patents

A patent is a property right to an invention granted to an inventor. In the United States, the federal government will grant a patent to anyone who "invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvements thereof[.]"[58] The term "manufacture" refers to any article which is made. While, the term "composition of matter" relates to chemical compositions and may include mixtures of ingredients as well as new chemical compounds. All told, the subject matter of patents includes practically everything which is made by humans and the processes for making the products.

To obtain a patent, an invention must be new, non-obvious, and useful.[59]

- **New.** The invention must be a new idea—meaning a patent will not issue if the invention is known or used by others, described in any publication anywhere more than one year prior to the application. Inventors must be able to describe how their inventions differ from "prior art" (what already exists).

- **Non-obvious.** The invention must not be an obvious extension of prior art. That is, it must be sufficiently different from what has been used or described before so that it is not obvious to a person having ordinary skill in the requisite area.

- **Useful.** The invention must have a useful effect or purpose.

If the subject matter is patentable and meets the other requirements for patentability, there are three categories of patents:

1) Utility patents for any new process, method, machine, manufacture, or compositions of matter, or any new and useful improvement to them.

2) Design patents for new, original, and ornamental designs for an article of manufacture (that is to say, appearance is protected by design patents).

3) Plant patents for distinct and new varieties of plants that have been invented or discovered and asexually reproduced.

Patent property rights give an inventor the opportunity to "exclude others from making, using or selling the invention" for a term of 20 years from the date of filing the application.[60] In return, the inventor must disclose the details of the invention so others

[58] 35 U.S.C. § 101.
[59] *See id.* §§ 101-03.
[60] *See id.* § 154(a)(1)-(2).

may seek improvements or new uses. Thus, the inventor benefits from this period of exclusive control of the invention, and society benefits from the further advancements that may be made on the technology. This balance was anticipated in the U.S. Constitution. Once the patent expires, anyone can freely use the invention covered by the patent.[61]

A patent owner who sells patented articles directly or through a licensee must mark each article or its packaging with the word "patent" (or "pat.") together with the patent number. Failing do so will prevent the owner from recovering damages for infringement for the period of time before an infringer received a notice alleging infringement. "Patent pending" and "patent applied for" may be used to inform the public that a patent application has been filed in the USPTO.

2. Obtaining a Patent

Patents are granted on a "first to invent" rather than a "first to file" basis. But an application should be filed as soon as the invention is made and reduced to practice and ideally before the invention is disclosed to the public. In the United States, an inventor has up to a year to file a patent application after the invention has been publicly disclosed, published, or offered for sale.[62]

Obtaining a patent begins with filing a patent application with the USPTO.[63] This is done by an attorney who is a member of the U.S. Patent Bar. The application should include a detailed description of the invention, drawings if applicable, a declaration that the inventors believe they are the original and first inventors of the subject matter of the application, and a fee. The application must explain how the invention differs from prior art and include a number of "claims" that succinctly define the scope of the invention.

Applications are reviewed by patent examiners through a process called "patent prosecution." Typically, some or all of the claims will be rejected. Relatively few applications are allowed as filed. Patent prosecution typically takes over two years. Notably, patent examiners do not determine whether the invention infringes any prior patent.

A provisional patent application ("PPA") allows an inventor to file a less formal application to obtain a priority date at a lower cost. The PPA expires in one year, and at that time a nonprovisional patent application must be filed to preserve the priority date already established.

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[61] *See id.* § 271.

[62] Most other countries and jurisdictions follow an "absolute novelty" rule, which provides no such grace period. In those countries and jurisdictions, if the invention has been publicly disclosed before a patent application is filed, then the inventor is barred from obtaining a patent on the invention.

[63] *See id.* § 111.

3. Patent Infringement

Infringement of a patent arises from the unauthorized making, using, offering for sale, selling, or importing of a patented invention in the United States. Patent infringement litigation must be filed in the United States federal district courts. Patent appeals are heard by the Court of Appeals for the Federal Circuit and, finally, by the U.S. Supreme Court.

To assess whether infringement has occurred, the patent claims are compared to the challenged product or process. The challenged product or process must use the claim either directly or equivalently. Defenses to a claim of infringement include that the patent is invalid or that the challenged product or process does not infringe the patent.

If patent infringement is found, the infringer may be ordered to stop using the patent. It may also be required to pay damages to compensate the patent owner, but not less than a reasonable royalty for use of the invention (the court may treble these damages) and interest and costs. Attorneys' fees may be awarded to the prevailing party in exceptional cases.

Patent litigation can be costly, generally costing several million dollars if the case is tried. A large percentage of patent ligation is filed by "patent trolls" which are seeking to exploit patents for their litigation or settlement value rather than use them in the marketplace.

4. International Protection for Patents

Patent rights are highly territorial. For example, making, selling, or using a product or process patented in the United States in a foreign country does not directly infringe the United States patent. Thus, information contained in a foreign patent where there is no corresponding United States patent may conceivably be leveraged in the United States in a way that avoids infringement of that specific foreign patent (and vice versa).

II. Franchising and Intellectual Property

Trademarks, trade secrets, and other confidential and proprietary information play a vital role in a franchised business. They impart valuable information to franchisees, teach them how to operate the business, provide brand recognition, and give a system its competitive advantage. Because of this, most franchisors go to great lengths to protect their intellectual property rights both within and outside of the franchise system. Franchisors can do this by using a variety of means, including through strong, but appropriately tailored, restrictive covenants and other provisions in their franchise agreements. This Section discusses common ways franchisors can protect the intellectual property of their brands.

A. Separate Entity for Intellectual Property

Franchisors generally create a separate entity to own and hold their intellectual property, particularly the trademarks. That holding entity should enter into a licensing agreement with the franchisor, under which the entity grants the franchisor a sublicense and perpetual right to use the marks. This structure works to insulate liability related to the marks and protect the marks as an asset (in addition to protecting franchisor's other assets) in the event litigation or other issues arise.

B. The Franchise Disclosure Document

The franchise disclosure document ("FDD") requires certain disclosures that relate to a franchisor's intellectual property. These disclosures are found in 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), Item 16 (restrictions on what franchisees may sell), and Item 18 (public figures associated with the franchise). Each is discussed below.

Item 13 requires a franchisor to list the trademarks identifying the goods or services sold by the franchisee. It requires disclosure of whether the trademarks are federally registered or registered in a state, and whether any claims, settlements, or agreements affect the ownership, use, or licensing of the trademarks. If a franchisor does not have a federally registered trademark, it must disclose that in Item 13, alongside the risks of not having a federally registered trademark.

Item 14 requires a franchisor to describe generally all other types of intellectual property associated with the franchise—specifically, information about patents, copyrights, and other proprietary information. In addition, the franchisor must describe all legal proceedings, settlements, and restrictions affecting these rights and any franchisee's ability to use the intellectual property. Franchisors must also disclose whether they have any pending patent applications associated with the system.

Items 15 and 16 relate to the franchisee's obligations that necessarily effect the operation of the business and the goods and services sold under the trademark. This in turn affects the public perception of the business and the goodwill associated with the mark. It is important that each franchisee takes steps to operate the business as well as possible and sell only authorized goods and services. This will enhance the consistency of the brand system-wide.

Item 18 requires disclosure of all public figures associated with the franchise, along with any management responsibilities of that public figure, total investment made by that figure, and any compensation received. A franchisor must disclose any compensation or other benefits given to a public figure if the franchisor uses the public figure's name, image, or endorsement or recommendation for the purpose of selling franchises (rather than the underlying products or services). A franchisor must also disclose the extent of a public figure's involvement with management or control of the franchisor.

C. Key Franchise Agreement Provisions

Franchise agreements generally contain a number of provisions designed to protect the intellectual property of the franchisor and its affiliates such as restrictive covenants, provisions defining the ownership and use of intellectual property, and remedial and monitoring provisions.

1. Restrictive Covenants

Franchise agreements often contain several types of restrictive covenants. These provisions serve to prevent current and former franchisees from misappropriating the franchisor's intellectual property or improperly competing with the franchise system, both during and after the term of the franchise agreement. Restrictive covenants are important for protecting the franchisors' confidential information, business methods, goodwill, brand value, and customer loyalty, as well as its investments of training and other resources in the franchisee. These protections are important to the franchisor itself and also to the integrity and goodwill of the brand and the franchise system.

The two principal issues that franchisors should consider when drafting and negotiating restrictive covenants are: (i) the scope of the covenants to ensure the franchisor's interests are adequately protected; and (ii) the enforceability of the covenants. While franchisors may be tempted to draft extremely broad covenants to ensure protection from all potential competitive threats, this strategy can be at odds with maximizing the likelihood of enforcement. In order to enhance the prospects of enforceability, franchisors should try to tailor their restrictions specifically to protect the franchisor's legitimate business interests in light of the potential competitive threat. Overbroad restrictive covenants that go beyond protecting the franchisor's legitimate business interests can be subject to attack by franchisees on public policy grounds, including as improper restraints on competition and improper restrictions on the franchisee's ability to earn a livelihood.

Restrictive covenants are governed by state law; thus, enforceability can vary substantially by state.[64] Moreover, enforceability is often (but not always) a fact-intensive inquiry. Therefore, it is important for franchisors to consider consulting with local counsel in the jurisdictions where they may seek to enforce the covenants, rather than simply relying on a "one size fits all" approach. While franchisors may be able to dictate the governing law by including a choice-of-law provision in the franchise agreement, a choice-of-law provision may not be dispositive. Some courts have disregarded choice-of-law provisions that if enforced would violate the public policy of

[64] For example in many states, restrictive covenants are governed by common law rules, but others have enacted statutes governing restrictive covenants.

the forum by leading to the enforcement of otherwise unenforceable restrictive covenants.

Many states evaluate the enforceability of restrictive covenants based on reasonableness—looking at the duration, territory, and scope of prohibited activities. Often, these factors are viewed on a sliding scale. If a restrictive covenant is found to be overbroad and unreasonable as drafted, some states permit the courts to modify or "blue pencil" the covenant. Other states do not permit modification and hold overbroad covenants unenforceable in their entirety.

While restrictive covenants are typically part of the franchise agreement, they can also be part of a separate agreement between the parties, either at the inception of the franchise relationship or later on. If a separate agreement is executed later in the parties' relationship, it is essential that the covenants are supported by adequate consideration. Franchisors can also bind individual owners, operators, or principals of the franchisee to restrictive covenants by having them separately agree in writing to be bound (for example, in a personal guaranty of the franchise agreement).

One issue that arises in the franchise context is whether restrictive covenants can be enforced against non-signatories. This is important given that many franchisees are family-run or otherwise closely-held businesses. While the law on this issue varies, courts often apply an equitable approach and enforce restrictions against franchisees' family members, associates, and other companies—even if they are not signatories to the contractual restrictions—if failing to do so would effectively allow the franchisee to avoid the restrictions. In addition, Federal Rule of Civil Procedure 65 provides that injunctions and temporary restraining orders bind not only the parties enjoined, but also "the parties' officers, agents, servants, employees, and attorneys," and anyone else "in active concert or participation" with the parties.[65] Federal courts use this provision to enforce contractual restrictions against non-signatories where justice requires it, and certain states also have statutory provisions governing which parties can be bound by restrictive covenants.

The most common restrictive covenants are: (1) non-competition provisions; (2) non-solicitation provisions; and (3) non-disclosure or confidentiality provisions.

Non-competition covenants prohibit a franchisee from engaging in competitive business activities during the term of and for a specified period of time after the franchise relationship. A properly drafted non-competition covenant will restrict a franchisee and its owners from opening or participating in a competitive business that is likely to undermine the franchisor's business or otherwise harm the franchise system.

Non-competition covenants are necessary to prevent the franchisee from using the general skills and industry knowledge gained from the franchise relationship to unfairly compete with the franchisor in the same market. Courts interpreting such

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[65] FED. R. CIV. P. 65(d)(2).

provisions often look to balance the franchisor's right to protect its intellectual property with the franchisee's interest in earning a living. State law on this point varies with some limiting non-competition covenants to the territory in which the franchisee operated with others permitting broader enforcement. Some geographic limitations to a non-competition covenant are usually necessary for enforcement. Most jurisdictions will enforce non-competition covenants if they are reasonable.[66] The primary factors in this analysis are the scope of the restricted activities, the geographic territory covered by the provision, and the duration of the restriction.

Non-solicitation covenants aim to prevent a former franchisee from poaching the franchisor's customers, vendors, suppliers, and employees after the franchise relationship comes to an end. State law governs whether or not these restrictions must be limited to a particular territory or apply only to customers and employees with whom the franchisee has had contact. Enforcement of non-solicitation covenants turns on similar considerations as non-competition covenants, although non-solicitation provisions are often viewed more leniently by courts as they are less restrictive.

Finally, non-disclosure and confidentiality covenants protect against the improper disclosure and distribution of the franchisor's confidential information and trade secrets. These provisions must clearly define what information is considered confidential and specify whether the restriction applies to both tangible and intangible information. These covenants should include an express acknowledgment by the franchisee that it was given access to the defined confidential information.

Non-disclosure covenants provide additional rights to trade secret protections and common law remedies—they do not supersede them. That being said, a non-disclosure covenant is critical for protecting against the disclosure and use of information that is confidential but does not qualify as a trade secret. For purposes of enforceability, franchisors should determine whether applicable state law requires a time limit or permits non-disclosure covenants to last indefinitely (provided that the information at issue remains confidential).

2. Defining the Rights of the Franchisor and the Franchisee

To ensure the proper use of a franchisor's intellectual property, it is important to clearly define ownership of the intellectual property, the franchisee's scope of use, and the rights retained by the franchisor.

All franchise agreements contain sections granting the franchisee the right to use the franchisor's marks and system and otherwise operate the franchised business, typically in a designated territory. These rights should also include restrictions that require the franchisee to use the marks and system only in keeping with the franchisor's standards and specifications. Franchisors generally issue these standards and

[66] One notable exception is California, which generally does not permit contractual non-competition restrictions. *See* CAL. BUS. & PROF. CODE § 16600, *et seq.*

specifications in writing through the operations manual and retain the ability to unilaterally change them. The reservation of these rights allows the franchisor to administer and develop the system; maintain brand uniformity and quality control; and protect the trademarks, trade secrets, and other confidential information.

The franchise agreement might also list those rights *not* granted to the franchisee such as: (i) the right to open additional franchise businesses; (ii) the right to sublicense or subfranchise the rights granted under the franchise agreement; and (iii) the right to use the proprietary marks and system for any other purpose other than operating the franchised business. Specifically discussing these exclusions and not others could potentially create a problem. However, that concern is typically overridden by the clarity that explicitly excluding these rights provides.

Similarly, the franchise agreement should list the exclusive rights retained by the franchisor, such as the ability to: (i) license the marks and the system to other parties outside of the franchisee's territory; (ii) use the marks in alternative channels of distribution; and (iii) use the marks and the system and license others to use the marks and the system to engage in any other activities not expressly prohibited by the franchise agreement. These rights help ensure that the franchisor has full control and use of its intellectual property.

The franchise agreement should also include a "work for hire" provision, which will give the franchisor ownership of all developments made during the term of the agreement. The provision should transfer ownership automatically to the franchisor, but it may also contain a requirement that the franchisee take all reasonable and necessary actions to ensure the transfer of rights to franchisor. When drafted correctly, work for hire provisions will enable the franchisor to use new and useful developments for the benefit of all franchisees and the entire system.

3. Monitoring and Remedial Provisions

The franchise agreement should contain provisions allowing a franchisor to enter a franchisee's premises to inspect the operations and use of the mark to determine if the franchisee is following the franchisor's standards and specifications. Additionally, franchisors should consider including in their franchise agreements other provisions to monitor and protect the goodwill of the brand such as "best efforts" and "loyalty" clauses.

Every franchise agreement should contain provisions that result in the franchisee's default if the franchisee does anything to harm the goodwill associated with the trademarks. Equally important are detailed provisions outlining the steps the franchisee must take upon the end of the franchise relationship, including: (i) debranding and deidentifying the business; (ii) ceasing all use of the franchisor's trademarks (removing signs and logos; returning or destroying branded material or items containing the franchisor's name; and taking down websites and social media pages); and (iii) returning all property, documents, and other tangible information belonging to the franchisor, including all manuals and training materials. Typically, franchisors will also require franchisees to assign all internet domain names, websites, and telephone numbers associated with the franchised business to the franchisor. Not only do these provisions clarify the parties' respective rights, but they also provide a means to protect the franchisor if a former franchisee improperly operates a competitive business after termination.

Most franchise agreements contain dispute resolution procedures. If these provisions mandate mediation or arbitration, it is important that they also include a carve out allowing the franchisor to seek immediate injunctive relief in court for any violation of its intellectual property rights. Since infringement of intellectual property will typically cause irreparable harm, this ability is essential to protecting the intellectual property.

D. Policing the System

A franchisor must police the brand and maintain quality control to ensure the continued protection of its principal trademarks and trade secrets. If a franchisor fails to do so, then it may lose its rights in the mark by abandonment or its rights in the trade secret by disclosure.

For example, if a franchisee begins using the franchisor's main trademark in connection with goods or services unauthorized by the franchisor and the franchisor does nothing, the franchisee may be deemed to have obtained a "naked license." According to commentators and courts, a naked license poses a "grave danger that the public will be deceived by such a usage." 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."[67] Federal courts have deemed a mark abandoned based on naked licensing with inadequate quality controls.[68]

Abandonment aside, failing to police trademark rights may result in the loss of goodwill in the mark and damage to the reputation of the brand. A franchisee that ignores a franchisor's operating requirements and runs an unsanitary restaurant may cause a ripple of unappealing publicity and perhaps a negative connotation associated with the franchise system as a whole. This might result in lower gross sales for units system-wide, and it might also impair the franchisor's ability to sell more locations and expand the system. Trademarks identify the system to the public and unify franchisees and the franchisor under a common identifier—this common identification applies to both positive and negative consumer opinions. As a result, franchisors should monitor the system to ensure that franchisees are not taking actions that would undermine the uniformity of the brand, impair the goodwill in the marks, or comprise the competitive advantages of the system through disclosure of confidential and proprietary information.

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[67] 15 U.S.C. § 1127.

[68] *See, e.g.*, *FreecycleSunnyvale v. Freecycle Network*, 626 F.3d 509, 515 (9th Cir. 2010).

A franchisor that fails to protect its intellectual property risks its entire system. Thus, franchisors should take appropriate steps to maintain their most important intangible assets—trademarks and trade secrets—and to properly enforce their other intellectual property rights when necessary.

III. Enforcement Options and Implications

During the course of running a franchise, a franchisor will necessarily need to enforce its intellectual property rights under the franchise agreement and otherwise. There are various ways to do so.

Much of the intellectual property litigation involving franchisors and franchisees stems from a franchisee's breach of the restrictive covenants contained in the franchise agreement, specifically, the franchisee's continued use of the franchisor's intellectual property after the franchise relationship ends. When that happens, the franchisor must carefully consider its available remedies. In response to a franchisee's breach of contractual restrictive covenants, the franchisor's options may include: (1) seeking injunctive relief; and (2) filing suit or initiating an arbitration seeking monetary damages to compensate the franchisor for its losses.[69]

Given that franchisors can suffer irreparable harm if their intellectual property is misappropriated—such as damage to the brand and the franchisor's goodwill—the most important step is usually to stop the improper competition or misappropriation as soon as possible. Therefore, if sending a strongly worded cease and desist letter to the franchisee does not stop the conduct, the franchisor's first priority is often to seek immediate injunctive relief.

Though necessary, these actions may implicate disclosure responsibilities in the FDD, depending on the approach taken and the results. Further, before taking any of these steps, franchisors are well advised to analyze the costs to prosecute or defend; the bottom-line negotiating point; what is really important to the business; and the risks versus the rewards.

A. Cease and Desist Letters

Upon learning of the infringement of its intellectual property rights, the first step for a franchisor is often to send the infringing party a cease and desist letter demanding that the infringing conduct stop. Sometimes, counsel will skip this step if the

[69] If a breach 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.

infringement is such that the franchisor cannot afford to wait to see if the infringing party complies or if there is a risk that the infringer will file a lawsuit first in an unfavorable forum.

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, documenting the franchisor's efforts to protect its intellectual property rights, triggering the infringing party's obligation to preserve documents, and trying to resolve the dispute without the need for judicial intervention. In its demand letter, the franchisor should instruct the infringing party to preserve all documents relevant to the dispute, and it should take appropriate steps to preserve its own documents in light of the potential for litigation.

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, counsel will opt to enclose a copy of the proposed lawsuit to the infringing party with the explanation that the suit will be filed if the party does not cease and desist. This tactic generally only operates to provide the adversary with advance notice of the claims, and again runs the risk that the infringing party will file first and deprive the franchisor of its choice of forum.

B. Damages

Franchisors might seek to recover monetary damages from a franchisee. This strategy should begin with an analysis of whether the franchisee or any guarantors have collectible assets. While concrete and quantifiable damages resulting from improper competition and breach of the franchise agreement can be difficult to prove, franchisors that are able to do so can be awarded compensatory damages under the breached contract.

Many franchise agreements contain liquidated damages provisions providing for a specific measure of recoverable damages upon termination of the franchise agreement. These calculations are often based on a percentage of past sales or royalties. The enforceability of liquidated damages provisions is governed by state law. 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. If the contract does not contain a liquidated damages provision, the franchisor may still be able to recover lost future royalties. These damages attempt to quality the amount necessary to put the franchisor in a position equivalent to where it would have been had the franchise agreement remained in effect. Courts are not always willing to award this type of damages, but if they are, the franchisor has the burden of presenting sufficient evidence from which to calculate the amount of the lost future royalties.

Notably, these contractual damages are in addition to any amount the franchisor may seek for infringement of applicable intellectual property statutes, such as the

Lanham Act. *See* Section I for a discussion of available remedies for intellectual property infringement.

C. Injunctive Relief

It is critical that a franchisor take prompt action to protect its intellectual property 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. In addition, failing to take action to stop infringing conduct or improper competition in one instance could allow future infringers to argue waiver, lack of irreparable harm, or, in trade secret cases, that a franchisor has taken inadequate steps to protect its trade secrets. Given that a franchisor's intellectual property is often among its most valuable assets, franchisors need to be prepared to take appropriate steps to protect their intangible assets in the event that disputes cannot be resolved outside of court.

An injunction is an order from the court for the infringer to stop the infringing conduct. Often, the 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. The failure to do so can be used to demonstrate a lack of irreparable harm resulting from the conduct at issue or to support a laches or estoppel argument.

Typically, the types of available injunctive relief are emergency temporary restraining orders ("TROs"), preliminary injunctions, and permanent injunctions. In federal courts, Federal Rule of Civil Procedure ("Rule") 65 governs injunctions.

A TRO is a temporary order (often entered on an emergency basis) that preserves the *status quo* until adjudication of the request for preliminary injunction. A TRO can, under appropriate circumstances, be entered *ex parte* (without notice to the defendant). A movant in federal court typically seeks a TRO simultaneously with, or very close in time to, filing its initial complaint. The movant must verify the facts upon which the temporary order is sought, either by filing a verification of the complaint or one or more affidavits. If the order is sought *ex parte*, 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. TROs issued without notice may not extend longer than 14 days (with limited exceptions). Rule 65 provides that when 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."[70] Generally, TROs should be granted without notice only in "extraordinary situations." Where the adverse party has received advance notice

[70] FED. R. CIV. P. 65(b)(3).

of the hearing, the district court has discretion to convert the hearing into a preliminary injunction hearing.

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 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. The injunction remains in effect until the case is finally determined on the merits.

Generally, a franchisor seeking a preliminary injunction must establish each of the following four factors:

- that the franchisor is substantially likely to succeed on the merits of its claims;
- that the franchisor will suffer irreparable harm if the injunction is not entered;
- that a balancing of the harms and equities favors issuing the injunction; and
- that issuance of the injunction would be consistent with the public interest.

This is a heavy burden, but it is achievable in intellectual property and unfair competition cases, where the harm from infringement or misappropriation is often great. Obtaining a preliminary injunction can often be one of the most critical steps in intellectual property infringement or unfair competition cases.

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.

A permanent injunction is a final, permanent ruling on the merits of the plaintiff's injunction claim. In order to obtain a permanent injunction at the conclusion of the litigation, franchisors generally must satisfy the same factors, but must have actually prevailed on the merits of their claims.

D. Disclosure Implications

A franchisor's enforcement of its contractual and intellectual property rights has implications for the FDD. Specifically, the FTC mandates that franchisors disclose information related to franchisor-initiated lawsuits in certain circumstances. The FTC's Rule on Franchising states that a franchisor must disclose 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.[71]

This disclosure requirement only arises in connection with actions related to franchisees, not suppliers or other third-parties. The need to disclose certain lawsuits in the FDD should encourage franchisors to be prudent about the types of suits they file, as the disclosures might affect franchise sales and the overall perception of the franchisor. The disclosure of lawsuits is certainly not always a negative mark in the FDD or on the franchise. For example, filing several suits to enforce brand standards or protect the trademarks may signal to prospective and current 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.

[71] 16 C.F.R. § 436.5(c)(1)(ii).