

# Who Takes What: The Parties' Rights to Franchise Materials at the Relationship's End

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The franchise agreement governs the relationship between a franchisor and its franchisees not only during the franchise relationship but also thereafter. A key focus in drafting such an agreement, therefore, should be who takes what at the end of the franchise relationship. Because the franchisor provides primarily nonmonetary consideration, the particular question that arises is what, if any, of that consideration the franchisee may retain when the franchise relationship terminates.

The most fundamental consideration exchanged in a franchise relationship is the trademark license that a franchisor grants its franchisee,<sup>1</sup> and therefore most franchise agreements are devoted primarily to that license. When the franchise agreement comes to an end, it is usually fairly clear that the franchisor retains the rights in the trademarks and that the franchisee relinquishes any right to use those marks.<sup>2</sup> In addition, however, franchisors provide a host of other things of value, tangible and intangible, to their franchisees. Some are related to the franchise trademarks (such as goodwill, domain names, and telephone listings), while others are not (such as trade secrets, confidential information, equipment, and intranet access). Even the most carefully crafted and detailed franchise agreement may not clearly address the rights of the respective parties with respect to such assets. For example, what aspects of the operations manual constitute trade secrets and confidential information such that a franchisor rightfully can prevent a former franchisee from using them? What happens if the franchisee has improved on those trade secrets? What can a franchisor do to stop a third party (such as a close friend or relative of a former franchisee) from using confidential information it has received from a former franchisee? Who owns the local goodwill associated with a particular franchised location, and who is entitled to payment for it when a franchise agreement terminates? All of these issues can cause serious problems in any franchise termination, no matter how cordial, if not addressed in advance. This article will address those issues in a pragmatic way to assist the parties in dealing with them (or at least anticipating them) before they arise.

## Sources of Law

The parties to a franchise agreement have a variety of rights arising from diverse sources of law. The most obvious and familiar source is the franchise agreement itself, which, in the absence of statutory restrictions, governs nearly every aspect of the parties' relationship.<sup>3</sup> Various state franchise relationship laws may affect what rights the parties have in intellectual property and materials exchanged during the relationship. Some states



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have laws requiring the franchisor to buy back equipment and inventory, and all states have statutes or common law governing trade secrets and confidential information. State statutes grant varying rights to franchisees and franchisors, so choice of law often becomes important. For instance, some states (Hawaii,<sup>4</sup> Illinois,<sup>5</sup> and Washington<sup>6</sup>) require franchisors to pay their former franchisees for local goodwill generated during the life of the relationship in certain circumstances, and others (Delaware, Indiana, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, and Virginia)<sup>7</sup> include loss of goodwill as compensable damages for wrongful termination.

Federal law may also come into play. The Lanham Act, of course, governs the trademarks at the heart of the franchise relationship and allows the licensing that makes a franchise agreement possible.<sup>8</sup> In the past, federal legislation has been

proposed that would require a franchisor to repurchase goodwill.<sup>9</sup> And franchisors must comply with the Federal Trade Commission's (FTC's) franchise disclosure rule.<sup>10</sup> If a franchisor regularly fails to disclose a material obligation of its franchisees with regard to materials provided during the relationship, the FTC could choose to initiate an enforcement action against that franchisor.

Finally, the common law may be the most important source of law impacting the parties' rights in materials exchanged during the relationship. Any dispute is likely to boil down to a basic question of property law: in the absence of a specific agreement, who owns which rights in the materials exchanged? Specific categories of state common law, especially those relating to trade secrets, will govern many of the more contentious areas, such as whether the franchisee may continue to use the scheme of business operation adopted by the franchise system.

## Equipment and Inventory

Many franchise agreements require that the franchisee purchase certain approved equipment and an initial (and continuing) amount of inventory. What happens to that equipment and any unsold inventory when the franchise agreement terminates or fails to renew? The default rule for items actually sold to a

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franchisee is, naturally, that the franchisee can keep those items after termination. However, when a franchisee is also a distributor of goods, or even when the franchise agreement requires the franchisee to purchase certain equipment to operate the business, state statutory laws may require the franchisor to repurchase equipment and inventory if the franchisor unilaterally ends the relationship.

Return, and perhaps repurchase, of tangible things should be addressed in every franchise agreement. Franchisees must fully understand what equipment they must pay for in addition to their franchise fees and whether or not they can expect to be reimbursed, in full or in part, for their outlay upon termination or nonrenewal of the franchise agreement. From the franchisor's perspective, a provision requiring the franchisee to return confidential information is critically important, and a repurchase provision may be an effective way to help ensure that franchisees do return such tangible information of value (like computer equipment) and fully de-identify the franchise location.

The generally applicable franchise laws of Arkansas, California, Connecticut, Hawaii, Michigan, Washington, and Wisconsin all impose repurchase obligations on franchisors in different circumstances. The following table summarizes franchisor

repurchase obligations under those state laws.

All of these state statutes reflect a public policy of protecting franchisees from the risk of making a large investment in goods or equipment required by the franchise system and, indirectly, from the risk of arbitrary termination. However, as discussed briefly above, a wise franchisor may use a contractual repurchase regime to help protect its valuable trademarks and confidential information. Such repurchase provisions serve to secure the return of confidential information and trademarked items at the franchised site and hamper the former franchisee's ability to continue using trade secrets. In addition, a franchisor may choose to compensate its franchisees for the present value of the inventory and equipment they hold to help ease a potentially troublesome transition (although such a program itself may lead to disputes, including disputes over the value of items to be returned).

In the right circumstances, a well-designed repurchase provision in the franchise agreement also may be a good supplement to a covenant not to compete.<sup>11</sup> For example, a franchisor that provides, or uses a particular third party to provide, information systems to its franchisees may find this technique useful. It would be much more difficult for a former franchisee to

State	Repurchase if terminated for good cause?	Repurchase required for nonrenewal?	What must be repurchased?	Price?
Arkansas <sup>1</sup>	No	No	Inventory, supplies, equipment, and furnishings purchased from the franchisor or its approved sources, not including personalized items that have no value to the franchisor	Franchisee's net cost less depreciation
California <sup>2</sup>	No	Yes	"[R]esalable current inventory meeting the franchisor's present standards that is required by the franchise agreement or commercial practice and held for use or sale in the franchised business"	"[T]he lower of the fair wholesale market value or the price paid by the franchisee"
Connecticut <sup>3</sup>	Yes	No	Inventory, supplies, equipment, and furnishings purchased by the franchisee from the franchisor or its approved sources, not including personalized items that have no value to the franchisor	"[F]air and reasonable compensation"
Hawaii <sup>4</sup>	Yes	Yes	"[I]nventory, supplies, equipment and furnishings purchased from the franchisor or a supplier designated by the franchisor," not including "personalized materials which have no value to the franchisor"; also includes goodwill if the franchisor takes over the location	Fair market value less removal costs and amounts due the franchisor
Michigan <sup>5</sup>	No	Yes	Inventory, supplies, equipment, fixtures, and furnishings, not including "[p]ersonalized materials which have no value to the franchisor" and items "not reasonably required in the conduct of the franchise business"	Fair market value
Washington <sup>6</sup>	No	Yes	"[I]nventory, supplies, equipment, and furnishings purchased from the franchisor, and good will, exclusive of personalized materials which have no value to the franchisor, and inventory, supplies, equipment and furnishings not reasonably required in the [course] of the franchise business," with no goodwill payment made if franchisee is given one year's notice and "franchisor agrees in writing not to enforce a covenant" not to compete	Fair market value less money owed franchisor
Wisconsin <sup>7</sup>	Yes	No	All trademarked inventories sold by the grantor to the dealer for resale under the dealership agreement	Fair wholesale market value

\*See page 127 for chart endnotes

continue using proprietary data and software after termination if it is obligated to sell its computer workstations back to the franchisor. And, if need be, repurchasing computer equipment allows a franchisor to perform forensic analysis on the equipment if the franchisor suspects that the franchisee may have copied or exported confidential information. The same advantages hold true for less high-tech equipment that may be sold to a franchisee: depending on the franchise, much of the value of the system may be in the business methods and equipment used to execute it. Depriving an ex-franchisee of these materials will help ensure that it cannot compete with its former franchise system using the system's own crown jewels. A franchisor, however, must be willing to repurchase such items when the time comes and accept the difficulties that may arise simply from offering a repurchase program.

### Trademarks

A franchise system's trademarks typically are the most important part of the franchise relationship. Therefore, the parties' rights in the marks must be well-established. The default rule is, naturally, that once the franchise terminates, the license to use the trademarks terminates.<sup>12</sup> If a licensor loses control of its trademarks, it faces the possibility that consumers will associate the shortcomings of its licensees with the marks, and the resulting irreparable harm should virtually always support a preliminary injunction.<sup>13</sup> It is hard to conceive of a situation in which a franchisee's monetary loss due to losing a trademark license would outweigh the harm to a franchisor caused by loss of control over its own marks.

Although the law in this area is helpful, franchisors nonetheless always should include provisions in the franchise agreement prohibiting the use of marks after termination. These provisions serve to put the franchisee on notice that the franchise is an ongoing relationship in which trademark usage is authorized in exchange for return performance during the term of the agreement, not an absolute right to operate a business under a particular system using a set of trademarks. Some commonly used provisions also may provide a practical way for a franchisor to engage in self-help against a holdover franchisee in certain circumstances, such as a provision allowing the franchisor itself to have signs removed.

### Confidential Information and Trade Secrets

A franchisee's desire to continue using confidential information and trade secrets can be a very contentious issue that may mar an otherwise amicable franchise expiration or nonrenewal. Many franchisors legitimately are concerned that they will teach a franchisee how to run a business, or at least how to run their particular system, and the franchisee will then exit the system and use the franchisor's intellectual capital in competition with the system. Franchisees, on the other hand, may be startled to learn that their former franchisor seriously expects them to unlearn what they have learned and consciously choose to use a less effective system, even if they have made their own improvements to the system over time. Drafters of franchise agreements should anticipate these competing concerns.

Franchisors may require the destruction or return of

enumerated categories of information, coupled with a reasonable geographic radius noncompete (in those jurisdictions where noncompetes are allowed), to prevent franchisees from using any residual trade secrets in competition with other franchisees in the area. This would allow the terminated franchisee to operate a new business that is not in direct competition with the franchise system without getting into definitional quicksand of what constitutes the franchisor's trade secrets.

Franchisors often are tempted to define their trade secrets in the franchise agreement as very broad, nonspecific categories of information. It usually is preferable, whenever possible, to be more specific.<sup>14</sup> Where a secret is truly valuable to the franchise system, a franchisor should try to identify it with enough specificity in the franchise agreement to prevent terminated franchisees from using it, without implicating the franchisee's concerns about ill-defined trade secrets, and without worry about disclosing the trade secret. In the event of litigation, the franchisor will need to identify its trade secrets with specificity.<sup>15</sup> Doing so in the franchise agreement, to the extent possible (without disclosing the secret), will help avoid conflict in the future and, in the event of litigation, will help satisfy the court that the items claimed as trade secrets so qualify.

There are two prominent definitions of trade secrets. The Uniform Trade Secrets Act, which has been adopted by forty-five states, the District of Columbia, and the U.S. Virgin Islands, 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.<sup>16</sup>

The other influential standard comes from the Restatement of Torts, which identifies six factors that courts may consider to determine if a given piece of information constitutes a trade secret:

- (1) the extent to which the information is known outside the business;
- (2) the extent to which it is known by the employees and others involved in the business;
- (3) the extent of measures taken to guard the secrecy of the information;
- (4) the value of the information to the business and to competitors;
- (5) the amount of effort or money expended in developing the information;
- (6) the ease or difficulty with which the information could be properly acquired or duplicated by others.<sup>17</sup>

To satisfy either standard, a franchisor must be prepared to prove that the information truly is secret and actually provides a competitive advantage. Laundry lists of broad categories of information in the franchise agreement or operations manual may serve only to make courts suspect that the franchisor is consciously overreaching, does not really know what its trade secrets are, or does not in fact have any trade secrets.<sup>18</sup>

One primary advantage of asserting trade secret protection

instead of (or in addition to) contractual confidentiality obligations is that the presence of trade secrets will support enforcement of a noncompete agreement.<sup>19</sup> In addition, because information loses its status as a trade secret if disclosed,<sup>20</sup> a franchisee's retention of trade secrets after termination will make it much easier to obtain an injunction against their use.<sup>21</sup> In a typical franchise system, many different types of confidential information may be eligible for trade secret protection. The franchise operations manual may constitute a trade secret, or at least contain trade secrets.<sup>22</sup> In a closely related vein, the franchise's business systems, formats, or methods may be trade secrets.<sup>23</sup> Other types of information may be trade secrets as well: business plans, strategic information, product information, recipes, formulas, customer and supplier information, new product development plans, proprietary computer technology, and so on.<sup>24</sup> Without careful controls and support from the franchise agreement, franchisors run the risk of losing trade secret protection in these materials when they deliver them to the franchisees. And, of course, franchisors should be especially careful about disclosing trade secrets before they are formally made part of the system, such as at a franchisee convention. Without the appropriate mechanisms to prevent disclosure, trade secrets will not remain protected for long.

In addition, some information might not be a trade secret but may still need to be kept confidential. Contact information for suppliers, customers, and prospective franchisees often can fall into this category if it is culled from publicly available databases.<sup>25</sup> In the absence of an agreement, franchisees may be free to do whatever they please with this information. If a franchisor would rather that certain data not be disclosed to the public and competitors, it is better to subject it to a nondisclosure agreement than to hope that a court will agree that it constitutes a trade secret.

A related topic, and one that has received some attention, is the possibility of obtaining business method patent protection for franchise business processes.<sup>26</sup> Ever since the Federal Circuit's famous decision in *State Street Bank & Trust Co. v. Signature Finance Group, Inc.*, business methods and software plainly are eligible for patent protection.<sup>27</sup> From the franchisor's perspective, the most obvious downside to patent protection is that the methods would have to be fully disclosed<sup>28</sup> and would be protected for only twenty years from the date of filing,<sup>29</sup> whereas trade secret protection lasts as long as the information is kept secret.<sup>30</sup>

There are some more subtle problems as well. A franchisee or a competitor could patent an improvement to the system. Such a blocking patent would make it more difficult to continue refining and developing the franchise system. This problem could be at least partially handled by requiring the franchisee to assign any improvements to the franchisor, a technique that is commonly used in patent licensing arrangements.

The astute reader already will have noted that improvements to a franchise system could be patented whether or not the underlying system is patented. Even if the components of a system constitute a trade secret and franchisees have confidentiality obligations, it is conceivable that an enterprising franchisee could obtain patents that are carefully drafted to teach

the improvement without exposing the underlying trade secret to the public domain. Although we have been unable to locate any cases involving such a fact situation, it is probably worth restricting such patents or requiring that franchisees assign them back to the franchisor.

The strongest reasons that a franchisor might have for considering whether to patent some of its business methods are that a patent strengthens the case for an injunction and could lead to enhanced damages for willful infringement if a franchisee continues using the method after termination.<sup>31</sup> Although courts will no longer automatically issue a permanent injunction after a finding of infringement,<sup>32</sup> the damage to the franchise system from ex-franchisees' continued use of a patented business system should strongly support a preliminary or permanent injunction.<sup>33</sup> Some courts may be suspicious of trade secret claims<sup>34</sup> but might find a franchisee's patent infringement a more concrete basis for an injunction.

### **Operations Manual and Other Written Materials**

In addition to protecting the trade secrets, confidential information, and business methods embodied in the various materials provided to franchisees, franchisors should be aware of how the copyright law may protect those materials themselves. Although copyright protection will not keep former franchisees from using what they have learned from an operations manual, it at least will provide a recourse if former franchisees make or distribute copies of the manual. This, coupled with a contractual obligation to return or destroy the operations manual, training and marketing materials, and other similar items, effectively may prevent franchisees from using the franchise system's methods after termination.

Copyright protection subsists "in original works of authorship fixed in any tangible medium of expression."<sup>35</sup> Copyright protection extends only to the work itself and does not protect ideas, procedures, or the like communicated through such a work.<sup>36</sup> Copyright initially vests in the author of the work. However, if a work is made for hire, that is, by an employee, copyright will vest in the employer.<sup>37</sup> Also, a commissioned work may be made subject to a written agreement stating that the work is made for hire.<sup>38</sup> In such an event, the copyright will vest in the commissioning party. The copyright holder must distribute the work with the proper notice (e.g., "©2008, ABA Forum on Franchising").<sup>39</sup> Registration of a copyright is not necessary to enjoin infringement, but it is a necessary prerequisite to a suit for infringement.<sup>40</sup> The Copyright Act allows for statutory damages between \$750 and \$30,000 for all infringements of a work and for enhanced statutory damages of up to \$150,000 in case of willful infringement,<sup>41</sup> which can be a major advantage and bargaining lever for a franchisor trying to keep the operating manual and other published materials from getting outside of the franchise system.

Once a party lawfully owns a copy of a work, that party may freely "sell or otherwise dispose of the possession of that copy."<sup>42</sup> This prohibition on control over "downstream" use of the copyright work is known as the "first sale doctrine."<sup>43</sup> However, the first sale doctrine is not a serious obstacle to preventing a former franchisee from transferring copyrighted

franchise materials to others because the franchise agreement may require the franchisee to destroy the materials. Further, the franchisor may grant the franchisee a license to use a copy of the operations manual during the term of the agreement without actually selling a copy to the franchisee. If a third party purchases or receives the copyrighted materials knowing that such a transfer is a breach of the franchisee's contract, it might be possible to maintain an action against the third party for aiding, abetting, or procuring the franchisee's breach.<sup>44</sup> Every franchise agreement should at least require the franchisee to return or destroy all materials provided to the franchisee during the relationship. In the absence of such contractual provisions, franchisees are free to do whatever they please with copyrighted franchise materials upon termination.

### Goodwill

Who owns the goodwill in a franchised location: the franchisor, the franchisee, or some combination of the two? This question exposes much of the fundamental nature of a franchise relationship. On the one hand, the franchisor has provided the trademarks that the location's customers recognize. On the other hand, the franchisee's efforts hopefully have improved the brand's goodwill and may even have developed goodwill that is unique to that specific location. The usual rule is that because the franchisor owns the trademarks, any enhancements in goodwill inure to the franchisor's benefit.<sup>45</sup> This rule is usually reinforced by franchise agreement provisions to the same effect. However, this is not an absolute, or even universally recognized, rule. Some courts have drawn a line between the goodwill that attaches to the franchise system and the goodwill that attaches to a particular location.<sup>46</sup>

Although goodwill will inure to the benefit of the trademark owner, if a franchise location really has become a part of the community, losing the franchise can cause very real monetary damage to the franchisee's business. As outlined above, some states require the franchisor to pay the franchisee for the diminution in the value of the franchise due to loss of the trademark license.<sup>47</sup> Some franchisors require the franchisee to make a payment on termination reflecting a purchase of the local goodwill from the franchisor. The reality is that both parties contribute in some fashion to the creation of local goodwill, and both have different interests in it.

As an example of the difficulty in determining the parties' interests in local goodwill, courts have leaned both ways when deciding whether the establishment of local goodwill supports or erodes a noncompete agreement. The franchisor's contribution to local goodwill may support enforcement of a noncompete.<sup>48</sup> If an ex-franchisee continues to operate a store under a different name in the terminated location, many consumers will understand that it is essentially the same store. Accordingly, the ex-franchisee would be free riding on the franchise system's goodwill. However, the franchisee's contribution may militate against enforcing a noncompete.<sup>49</sup> If a franchisee is not allowed to continue to operate its business in the same location, it loses its investment in improving goodwill at that location.

Given the mixed judicial messages on goodwill, the parties

to the franchise agreement should be sure to identify and plan for it in the agreement. By deciding in advance who (if anyone at all) should pay for local goodwill at termination, a potentially messy problem may be avoided entirely. Of course, any relevant state statutes must be considered because some states will require a goodwill repurchase regardless of the parties' contractual decision.

### Domain Names and Telephone Numbers

Internet domain names and telephone numbers are not provided by the franchisor to the franchisee, but they become associated with the franchise system as a whole while a franchise agreement is still in effect. In this way, they are closely related to local goodwill. A franchisee may have registered the domain name or phone number, but customers will associate it with both the specific location and the entire franchise system.

Courts typically will enforce a franchise agreement provision requiring franchisees to cease using or transfer to the franchisor specific phone listings and phone numbers.<sup>50</sup> Many franchisors may be concerned about potential for confusion if the listing simply changes names, particularly if the business is the type that involves frequent repeat business from the same local customers, such as a pizza delivery chain. On the franchisee side, a particular phone number may be extremely important to continuing the business after termination of the franchise relationship. Nonetheless, courts often will enjoin a former franchisee from continuing to use the same phone number after termination and will even require transfer of the numbers if there is a clear contractual obligation and the facts support it.<sup>51</sup>

A well-drafted franchise agreement also should address what is to be done with any domain names that the franchisee may register during the life of the relationship. Naturally, if the franchisee uses the name of the franchise system in its domain name, the franchisor will have a claim for trademark infringement against the franchisee for continuing to use that domain name after termination. Except in cases of criticism or parody, where the First Amendment comes into play, unlicensed use of a trademark in a domain name appears to have become essentially *per se* trademark infringement.<sup>52</sup> One notable exception is where the domain name registrant is a distributor of the trademark owner's goods and incorporates the trademark in a domain name to make a bona fide offering of the trademarked goods.<sup>53</sup> The best, and most common, way to avoid domain name problems is simply to forbid franchisees from using licensed marks in their own domain names. A profusion of different websites with similar addresses, all pointing to different franchise locations, is not generally a desirable feature of a franchise system. By keeping a central and unified Web presence, the franchisor can avoid difficulties with domain names registered by terminated franchisees.

If a franchisee creates its own website or other Internet service using a domain name not containing the licensed marks, there is no case for trademark infringement. It might be possible for a franchisor to proceed against a terminated franchisee under state unfair competition laws based on the theory that people associate the domain name with the franchise system due to its use during the term of the franchise agreement. As with domain

names containing system trademarks, it is probably better to agree to maintain a unified, central Web presence and forbid franchisees from using even their own domain names. If the franchisor takes its Web presence seriously, makes it an integral part of its marketing strategy, and above all provides useful content for increasing local sales, franchisees may be perfectly happy with such an arrangement.

### Third-Party Uses of Franchise Property

Terminated franchisees may attempt to circumvent their contractual obligations, including noncompetes and restrictions on use of franchise business methods and trade secrets, by having closely related people set up new businesses in competition with the franchise system. Although former franchisees may be prohibited from competing or using confidential information under the express terms of the franchise agreement, their spouses, relatives, and close friends may not be. The franchisor would be harder put to sue such parties because they are not parties to the franchise agreement. This same difficulty arises with any of the types of materials that a franchisor provides its franchisees.

A former franchisee's use of a third-party façade may occur after an injunction has already issued. In that case, it is fairly simple to enforce the injunction against the third party. As the Supreme Court has emphatically stated, "defendants may not nullify a decree by carrying out prohibited acts through aiders and abettors."<sup>54</sup> Under the federal rules, an injunction is binding "upon the parties to the action, their officers, agents, servants, employees, and attorneys, and upon those persons in active concert or participation with them who receive actual notice of the order."<sup>55</sup> Once an injunction is in place, it will be too late for the former franchisee to attempt to evade its post-termination obligations through the instrument of a third party.

However, a contempt order against an aider or abettor will often not be quick or direct enough where a terminated franchisee already has plans in place to continue business through, or share confidential information with, a closely related third party. To get a contempt order, the franchisor would have to file suit against the former franchisee (which may not be feasible if the parties have already settled or amicably allowed the franchise agreement to expire), obtain an injunction, provide notice of the injunction to the third party, and then petition the court for contempt sanctions if the third party continues its course of conduct.

When the third party becomes involved near the time of termination, a more effective method may be to sue the third party directly under a theory of aiding or contributing to the former franchisee's breach of its post-termination obligations. A recent article has identified three key factors in succeeding with such a claim in the context of a noncompete agreement: (1) proving a direct breach by the ex-franchisee, (2) establishing that the third party acted in concert with the ex-franchisee in breaching the agreement, and (3) showing a close or familial relationship between the ex-franchisee and the third party.<sup>56</sup> The same factors should apply regardless of whether the third party helps the ex-franchisee breach a noncompete or

some other substantive provision of the franchise agreement. Courts are often willing to entertain such suits either under a theory of procuring or assisting in the breach<sup>57</sup> or by imposing successor liability on the ex-franchisee's related party.<sup>58</sup>

### Conclusion

Although the key element of a franchise relationship is the license to use the franchise trademarks, the franchisor provides many other valuable things to the franchisee important for the successful operation of a business as part of the franchise system. Anything that the franchisor gives the franchisee is a potential subject of dispute upon termination or expiration of the agreement. The parties should carefully consider what their respective rights in these items and information should be, with particular attention given to intangibles such as local goodwill. Particularly in franchise systems that use noncompete agreements, franchisors must determine in advance what a franchisee can carry into a continuing business after termination. Most fundamentally, the parties to a franchise agreement should use care in laying out in advance what their relative rights and interests are with respect to every item of value that will be exchanged during the relationship.

### Endnotes

1. See, e.g., *Susser v. Carvel Corp.*, 206 F. Supp. 636, 641 (S.D.N.Y. 1962), *aff'd*, 332 F.2d 505 (2d Cir. 1964); *Perma Life Mufflers, Inc. v. Int'l Parts Corp.*, 376 F.2d 692 (7th Cir. 1967).
2. See *My Pie Int'l, Inc. v. Debould, Inc.* 687 F.2d 919, 921 (7th Cir. 1982) (terminated franchisee's continuing use of franchise trademarks constitutes infringement).
3. THE FRANCHISE AND DEALERSHIP TERMINATION HANDBOOK 23 (ABA 2004); Craig R. Tractenberg, Robert B. Calihan & Ann-Marie Luciano, *Legal Considerations in Franchise Renewals*, 23 FRANCHISE L.J. 198 (2004).
4. HAW. REV. STAT. § 482E-6(3), Bus. Franchise Guide (CCH) ¶ 4110.01.
5. ILL. COMP. STAT. 705/20, Bus. Franchise Guide (CCH) ¶ 3130.20.
6. WASH. REV. CODE § 19.100.180(i), Bus. Franchise Guide (CCH) ¶ 4470.01.
7. See Thomas M. Pitegoff & W. Michael Garner, *Franchise Relationship Laws*, in FUNDAMENTALS OF FRANCHISING 171, 198 (Rupert M. Barkoff & Andrew C. Selden eds., 2d ed. 2004).
8. See, e.g., *Susser v. Carvel Corp.*, 206 F. Supp. 636, 641 (S.D.N.Y. 1962), *aff'd*, 332 F.2d 505 (2d Cir. 1964).
9. The proposed Federal Fair Franchising Practices Act would have prohibited a franchisor from enforcing a restrictive covenant without first offering "to purchase the franchised business concerned for its fair market value as a going concern." See Federal Fair Franchising Practices Act of 1997, H.R. 1083, 105th Cong., 1st Sess., § 8 (1997).
10. 16 C.F.R. § 436.
11. See generally Richard E. Johnson & Richard G. Greenstein, *Achieving "Victory Through Prearrangements: Supplementing Covenants Not to Compete"*, 22 FRANCHISE L.J. 21 (2002).
12. See *My Pie Int'l, Inc. v. Debould, Inc.* 687 F.2d 919, 921 (7th Cir. 1982).
13. See *Burger King Corp. v. Mason*, 710 F.2d 1480, 1493 (11th Cir. 1983).
14. *Frosty Bites, Inc. v. Dippin' Dots, Inc.*, No. 3-01-CV-1532-M, 2003

WL 21196247, at \*4–5 (N.D. Tex. May 19, 2003) (declining to enforce nondisclosure agreement in part due to failure to identify trade secrets with sufficient specificity in agreement).

15. *See, e.g.*, *IDX Sys. Corp. v. Epic Sys. Corp.*, 285 F.3d 581, 583–84 (7th Cir. 2002).

16. UNIF. TRADE SECRETS ACT § 1(4).

17. RESTATEMENT OF TORTS § 757, cmt. b (1939).

18. *See, e.g.*, *Combined Metals of Chi., Ltd. v. Airtek, Inc.*, 985 F. Supp. 827, 832 (N.D. Ill. 1997) (expressing frustration with parties' unwillingness to define trade secrets and requiring submission of amended counterclaim identifying trade secret with particularity); *Utilase, Inc. v. Williamson*, 188 F.3d 510, 1999 WL 717969, at \*7–8 (6th Cir. Sept. 10, 1999) (unpublished disposition).

19. *Pepsico, Inc. v. Redmond*, 54 F.3d 1262 (7th Cir. 1995) (enjoining employment with competitor as a threatened misappropriation of trade secrets).

20. UNIF. TRADE SECRETS ACT § 1, cmt.

21. RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 44, at 500 (1993).

22. *See Gold Messenger v. McGuay*, 937 P.2d 907, 911 (Colo. Ct. App. 1997) (system of business described in manual was a trade secret).

23. RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 39, cmt. d.

24. *Id.*; *see also* 2 LOUIS ALTMAN, CALLMAN ON UNFAIR COMPETITION, TRADEMARKS, AND MONOPOLIES §§ 14:14–:24 (2005).

25. If such information is sufficiently difficult to compile or contains specific nonpublic information, it may still be susceptible to trade secret protection. *See Proimos v. Fair Auto Repair, Inc.*, 808 F.2d 1273, 1276 (7th Cir. 1987).

26. One article thoroughly examining the potential for business method patents in the franchise context is George Rosenblatt, Christina K. Peterson & Jody Lynn DeStafnis, *A Sleeping Tiger? Business Method Patent Protection for Franchise Systems*, 22 FRANCHISE L.J. 9 (2002).

27. *See State St. Bank & Trust Co. v. Signature Fin. Group Inc.*, 149 F.3d 1368 (Fed. Cir. 1998), *cert. denied*, 525 U.S. 1093 (1999).

28. 35 U.S.C. § 112.

29. 35 U.S.C. § 154(a)(2).

30. *See BondPro Corp. v. Siemens Power Generation, Inc.*, 463 F.3d 702, 708 (7th Cir. 2006) (injunction prohibiting use of misappropriated trade secret should terminate when secret becomes generally known or knowable to good faith competitors); *see also* ALTMAN, *supra* note 24, § 14:15.

31. *See, e.g.*, *Harris Corp. v. Ericsson Inc.*, 417 F.3d 1241, 1259 (Fed. Cir. 2005); 35 U.S.C. § 284.

32. *See eBay v. MercExchange, LLC*, 547 U.S. 388 (2006).

33. *See, e.g.*, *Nat'l League of Junior Cotillions v. Porter*, No. 3:06-cv-508, 2007 WL 2316823, at \*6 (W.D.N.C. Aug. 9, 2007) (*eBay v. MercExchange* did not overturn presumption of irreparable harm at preliminary injunction stage).

34. *See* RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 39, cmt. d.

35. 17 U.S.C. § 102(a).

36. *See Baker v. Selden*, 101 U.S. 99 (1879) (no copyright infringement where new book described same system of bookkeeping as plaintiff's book).

37. 17 U.S.C. § 101(1).

38. 17 U.S.C. § 101(2).

39. 17 U.S.C. §§ 401–406.

40. 17 U.S.C. § 411(a).

41. 17 U.S.C. § 504(c).

42. 17 U.S.C. § 109(a).

43. *See Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908).

44. *See* discussion below.

45. *See, e.g.*, *Pappan Enters. v. Hardee's Food Sys.*, 143 F.3d 800 (3d Cir. 1998).

46. *See, e.g.*, *Hill v. Mobile Auto Trim, Inc.*, 725 S.W.2d 168, 171 (Tex. 1987).

47. Most of the states require this payment as part of an inventory and equipment repurchase statute. Illinois appears to be unique in not requiring repurchase of anything but local goodwill. Illinois requires compensation “by repurchase or by other means for the diminution in the value of the franchised business” where the franchisee is not permitted to engage in the same business under a different name or does not receive six months' notice. *See* ILL. COMP. STAT. 705/20, Bus. Franchise Guide (CCH) ¶ 3130.20.

48. *See, e.g.*, *Jiffy Lube Int'l, Inc. v. Weiss Bros., Inc.*, 834 F. Supp. 683, 692 (D.N.J. 1993) (enforcing restrictive covenant against ex-franchisee to protect franchisor's goodwill).

49. *See Hill*, 725 S.W.2d at 171–72 (refusing to enforce restrictive covenant in part to protect franchisee's local goodwill), *superseded by* TEX. BUS. & COM. §§ 15.50–.51, *as recognized in* *Webb v. Hartman Newspapers, Inc.*, 793 S.W.2d 302, 303–04 (Tex. Crim. App. 1990).

50. *Sunward Elecs., Inc. v. McDonald*, 362 F.3d 17, 26–27 (2d. Cir. 2004) (upholding injunction related to telephone numbers but noting that courts do not generally require transfer unless provided for in franchise agreement and remanding to district court to determine least restrictive approach to protecting franchisor's interest in the phone numbers).

51. *Id.*

52. *See Cardservice Int'l, Inc. v. McGee*, 950 F. Supp. 737 (E.D. Va. 1997), *aff'd mem.*, 129 F.3d 1258 (4th Cir. 1997).

53. The dealer exception frequently arises in the context of the Internet Corporation for Assigned Names and Numbers' (ICANN's) Uniform Domain Name Dispute Resolution Policy (UDRP). *See, e.g.*, *Oki Data Ams., Inc. v. ASD, Inc.*, WIPO Case No. D2001-0903 (denying transfer of okidataparts.com where respondent was authorized repair center and was making bona fide offering of goods).

54. *Regal Knitwear Co. v. NLRB*, 324 U.S. 914 (1945).

55. FED. R. CIV. P. 65(d).

56. Michael R. Gray & Jason M. Murray, *Covenants Not to Compete and Nonsignatories: Enjoining Unfair Conspiracies*, 25 FRANCHISE L.J. 107 (2006).

57. *See, e.g.*, *Gold Messenger, Inc. v. McGuay*, 937 P.2d 907, 912 (Colo. Ct. App. 1997) (upholding injunction on third party based in part on third party's assistance in violating covenant).

58. *See, e.g.*, *Medicine Shoppe Int'l, Inc. v. S.B.S. Pill Dr., Inc.*, 336 F.3d 801, 804–05 (8th Cir. 2003) (imposing successor liability on new corporation with same officers operating at same location as “merely a continuation” of the franchised business).

## Chart Endnotes

1. *See* ARK. CODE ANN. § 4-72-209, Bus. Franchise Guide (CCH) ¶ 4040.09.

2. *See* CAL. BUS. & PROF. CODE § 20035, Bus. Franchise Guide (CCH) ¶ 4050.18.

3. *See* CONN. GEN. STAT. § 42-133f(c), Bus. Franchise Guide (CCH) ¶ 4070.02.

4. *See* HAW. REV. STAT. § 482E-6(3), Bus. Franchise Guide (CCH) ¶

4110.01.

5. The Michigan statute voids any franchise agreement provision that is not in compliance with the repurchase provision. The provision only applies if the term of the franchise is less than five years and the franchisee is prohibited from operating in the same area under a different trademark

or does not receive six months' notice. *See* MICH. COMP. LAWS § 445.1527, Bus. Franchise Guide (CCH) ¶ 4220.01.

6. *See* WASH. REV. CODE.

7. *See* WIS. STAT. § 135.045, Bus. Franchise Guide (CCH) ¶ 4490.06.