

WHEN DOES A LICENSE BECOME A FRANCHISE AGREEMENT?

A franchise brings to mind a fast food restaurant or coffee shop. Those involved in negotiating a patent or trademark license do not usually consider whether they are entering into a franchise agreement but they should. A franchise is basically a business that comes with instructions and requirements. Franchise agreements include some specific features that typically are absent from other agreements. Most states have enacted statutes to protect those that enter into a franchise agreement to address the usual disparity in bargaining power between a large company selling a franchise and a potential franchisee. State franchise laws require specific disclosures to the State and the potential franchisee prior to and during the term of the agreement, for example. Remedies for failing to provide the required disclosures can be extreme and often include provisions for complete rescission of the agreement and an award of damages.

Typically, a franchise statute applies to any agreement that has a requirement that fits within the terms of the statute,

regardless of the intent of the parties. For example, an agreement that grants the right to engage in the business of offering, selling or distributing goods or services under a marketing plan or system prescribed in substantial part by one party, where the goods or services are substantially associated with a trademark, service mark, trade name, logo, advertising or other commercial symbol and requires paying a fee that is not a royalty fee or a direct payment to purchase goods, may be treated as if it were a franchise agreement.

Courts have broadly interpreted these requirements to cover many different types of agreements, including license agreements. If a license agreement includes a provision requiring or granting the use of a trademark, service mark or logo along with the use of a service or product, the parties should look for other features of the agreement that may meet the other franchise law requirements. A “marketing plan” or system can be as simple as a standard operating procedure for producing, installing or using a product. Further, any fee that is not directly

associated with a purchase or royalty (e.g., a fee that is paid for the right to enter into the agreement) can fulfill the franchise law fee requirement.

If an agreement meets the broad requirements of a state franchise statute, some unintended consequences can result. For example, franchise statutes often include prohibitions against commonly included contract clauses. One example is the choice of law clause. Most states prohibit enforcement of any clause that requires litigation in another state. Other provisions restrict cancellation of an agreement without advance notice. This is in addition to the penalties associated with not providing the required disclosures.

For these reasons, it is wise to be aware of provisions in a license agreement that may unintentionally trigger application of a state franchise statute and all the disclosures and restrictions that accompany such statutes. This can be as simple as answering a few questions concerning any agreement.

1. Does the agreement require payment of any fee that is not directly associated with the purchase of a product or payment of a royalty?

2. Does the agreement grant or require marking or use of a trademark or logo?

3. Does the agreement include provisions for training and instruction or provide a desired standard operating procedure?

If the answer to any of the above is “yes”, it is worth taking a closer look at the provisions of the agreement in view of a relevant franchise statute. In some cases, care should be taken to prevent unintentionally entering into a franchise agreement. For example, small changes to an agreement’s wording can prevent the accidental formation of a franchise agreement. On the other hand, in some instances, it may be beneficial to use a state’s franchise statute as leverage once an agreement is in place.

CAN A PAYING LICENSEE CHALLENGE THE PATENT IN COURT?

The US Supreme Court recently issued a somewhat surprising decision affecting patent licensing. The Court's holding in [*Medimmune v. Genentech*](#) appears to depart from the prior state of the law, which prevented a licensee from filing a declaratory judgment action against the patent licensor while continuing to pay royalties to the licensor under a licensing agreement. Courts previously refused to hear a declaratory judgment action filed by a licensee who wanted to invalidate the patent covered by their license. The fact that the licensee was paying royalties under a license was regarded as negating any "case or controversy" between the licensee and the patent owner. Without a case or controversy between the parties, a federal court does not have jurisdiction over the matter.

In this case, Genentech accused Medimmune of infringing a patent ("Cabilly I") for an antiviral drug. Medimmune agreed to take a license from Genentech to allow Medimmune to market their antiviral drug allegedly covered by the Cabilly I patent. Later, Genentech notified Medimmune that it obtained a related patent ("Cabilly II") and demanded that Medimmune pay royalties on Cabilly II, also. Medimmune considered this a threat to enforce Cabilly II and terminate the

license under Cabilly I if Medimmune refused to make the additional royalty payments. Even though Medimmune continued to pay royalties according to the Cabilly I license, Medimmune filed a declaratory judgment action seeking to invalidate the Cabilly I and Cabilly II patents.

After discussing the applicability of such cases as *Lear v. Adkins* and *Altwater v. Freeman*, which prevented a paying licensee from challenging the validity of a licensed patent, the Supreme Court found a sufficient case or controversy between Medimmune and Genentech so that federal court jurisdiction exists.

The *Medimmune* decision could apply to licenses that do not include express language that cancels the agreement if the licensee challenges the validity or enforceability of the licensed patent. A licensor under some circumstances is potentially exposed to the risk of a potential declaratory judgment action even though the licensee continues to pay royalties under an existing license.

THE SUGGESTION-MOTIVATION-TEACHING SAGA

CONTINUES

The Court of Appeals for the Federal Circuit (“CAFC”), in [*Alza v. Mylan*](#), laid out what some speculate to be a brief treatise intended as a tutorial for the Supreme Court’s consideration of the law surrounding obviousness in *KSR v. Teleflex*.

Alza appealed from a finding of noninfringement and invalidity of its patent on an extended release rate of the drug oxybutinin. Alza’s patent claims were found obvious by the CAFC in view of three prior art patents and the testimony offered by Mylan’s expert witness. Mylan’s expert established what the prior art as a whole taught based upon the knowledge that one of ordinary skill would have had at the time of Alza’s patent.

The CAFC reviewed the suggestion-motivation-teaching test for obviousness in an apparent effort to explain that such a test is mandated by long existing jurisprudence and legislation. As part of its tutorial, the CAFC pointed out aspects of the Supreme Court’s *Graham v. John Deere* decision, the language of §103 of the patent statute and common sense that legal determinations “should be based on evidence rather than on mere speculation or conjecture.” Based on these, the CAFC concludes that the suggestion-motivation-teaching test cannot be considered by the Supreme Court as an invention by the

CAFC, but rather demanded by statute and case law.

Additionally, the CAFC explained its view that the suggestion-motivation-teaching test is not a rigid, unworkable standard as some have argued. The CAFC pointed out that instead, obviousness can be found not only by actual teaching, but also implicitly within the prior art.

While the cited prior art collectively included all of the Alza claim elements, Alza argued there was no motivation to modify any of the references to make Alza’s invention because there would be no reasonable expectation of success. In fact, Alza presented secondary considerations in support of nonobviousness citing that there was no documentary support for using the drug oxybutinin at the claimed release rate, including several articles that arguably taught the claimed release rates would not have been possible. The CAFC rejected Alza’s arguments and agreed with the lower court that the expert testimony and prior art, when viewed as a whole, supported the suggestion that one of ordinary skill would have perceived a reasonable likelihood of success and would have been motivated to combine the prior art to achieve the claimed invention.

The CAFC made its case for the soundness of the suggestion-teaching-motivation approach for determining

obviousness. It is yet to be seen whether the Supreme Court will agree or will require using a different test.

TRADEMARK DILUTION REVISION

The standard for trademark dilution has recently changed. Trademark dilution is defined as “the lessening of the capacity of a famous mark to identify and distinguish goods or services.” The two primary ways in which dilution occurs are dilution by blurring, where the distinctiveness of a mark is impaired, and dilution by tarnishment, where the reputation of a mark is harmed. In 2003, the Supreme Court held that the Federal Trademark Dilution Act of 1995 required a showing of actual dilution, rather than a likelihood of

dilution. This decision has led to significant inconsistencies in the type and quantity of evidence that is necessary to establish “actual dilution.” In an attempt to mitigate the problem, lawmakers revised the Trademark Dilution Revision Act of 2006 to require only that a plaintiff demonstrate a likelihood of confusion, not actual confusion, to prevail on a trademark dilution claim.

ANTICIPATION OF CHEMICAL INVENTIONS

For chemical-related inventions, patent examiners sometimes rely on a tenuous disclosure from a prior art reference that supposedly discloses the claimed chemical invention. A recent CAFC decision in [*Eli Lilly v. Zenith Goldline Pharmaceuticals*](#), however, is a reminder that the burden in establishing anticipation of chemical inventions can be especially demanding.

In *Eli Lilly*, the defendants challenged the validity of the patent claims based on anticipation. The test for anticipation is whether a prior art reference discloses each

and every feature of the compound, explicitly or inherently. The defendant argued for anticipation based on an article disclosing millions of compounds from the same family of compounds as the claimed compound. However, the CAFC disagreed and held that the claims were valid.

In finding the claims valid, the CAFC distinguished two previous cases that found claims anticipated because the prior art identified compounds from the same family as the claimed compound. In the previous cases, the prior art references

disclosed two families each having 14 and 20 compounds. Instead, the CAFC held that even though the article disclosed the same family of compounds, the article did not define a definite and limited class of compounds enabling a person of ordinary skill in the art to at once envisage the limited class of compounds.

The *Eli Lilly* ruling suggests that one could challenge a prior art disclosure during prosecution as being too broad and generic to

provide a legitimate disclosure of a claimed compound. However, it should be noted that the scope of the ruling might be limited by the facts of the case. For example, the article in the *Eli Lilly* case expressed certain preferences among the disclosed millions of compounds, and no possible combination of the preferences would have led to the claimed compound without modification of the chemical structures.

GOOGLE PATENT SEARCH

Google™ recently released a BETA version patent search engine: www.google.com/patents. Google™ Patent Search enables keyword searching of all issued U.S. Patents, including those published prior to 1974. Keyword searching for patents within Google™ is straightforward, and our initial evaluations have provided mixed results. An advantage of Google™ Patent Search is quick access to detailed patent information. For example, after selecting an individual patent, a user can view all the pages of the patent (including drawings) within a single display window. Links to any cited patents, or patents citing the displayed patent, are also shown. Many search tool options are available such as

Boolean searching and class-based searching. It appears Google™ scanned existing patents using optical character recognition software to generate their indexed patent database. For example, some of our search results have shown missed or incorrect characters, which is a drawback to relying on Google™ Patent Search for comprehensive search results. Although future versions may vary, the current version of Google™ Patent Search does not allow downloading an entire patent copy or searching published patent applications from the Google™ interface, as do some of the more sophisticated search databases.

MICHIGAN CONSIDERING SERVICE TAX

Michigan legislators are considering implementing a 2% tax on services, including legal services. Recently, the State Bar of Michigan issued a position statement against the proposal. The statement lists the following as reasons against adopting the proposal.

- A tax on legal services is a tax on citizens and businesses, not lawyers.
- Individuals and businesses seek legal advice in order to ensure compliance with the law. A tax on legal services would discourage individuals from seeking such advice. Failure to seek early legal advice could potentially result in more complex legal problems for individuals and businesses at later stages.
- A sales tax on legal services would deter individuals and businesses from taking proactive and responsible management measures, such as drawing a will, medical preferences, appointing guardians, incorporating a business.
- Individuals and businesses secure legal services for the purpose of ascertaining, exercising, and defending their legal rights, including constitutionally protected rights such as the right to representation for criminal defense.
- A tax on legal services is essentially a misery tax that would add a tremendous burden on individuals and businesses already facing significant financial stress and misfortune, such as domestic violence, divorce, child support, bankruptcy, debt collection.
- Most legal services are not discretionary.
- A tax on professional services would be detrimental to Michigan business interests and encourage individuals and businesses to seek legal services out of state. Small business firms would be affected at a much higher occurrence than large businesses that employ in-house counsel that would not be subject to the tax. Large businesses would be discouraged from seeking outside counsel for specialty or technical issues.
- Many legal transactions, such as property transfers and estate administration, are already taxed. Imposing a tax on legal services would result in double taxation for these transactions.

- Audits of taxes on legal services invade attorney/client confidentiality.
- The administrative and business difficulties experienced by Florida and Massachusetts in the wake of the passage of a tax on services that

included legal services caused both states to repeal the tax.

For more information, please refer to the [Tax Restructuring Proposal](#) of the State Treasurer of Michigan, or to www.michigan.gov.

ANNOUNCEMENTS

CGO is pleased to announce that Benjamin J. Coon has joined the firm as an associate attorney. Ben has been with CGO as an intern since early in 2005 and recently passed the Michigan State Bar Exam. He is registered to practice before the United States Patent Office. Ben graduated from GMI

Engineering & Management Institute and received his Juris Doctor degree from Wayne State University. Prior to joining CGO, Ben worked as an engineer for Johnson Controls and Ford. His practice will focus on litigation, prosecution, and related matters.

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