

BUSINESS METHOD PATENTS: ADDING TO THE FRANCHISOR'S ARSENAL

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Introduction

Franchisors have long packaged a business model along with a collection of intellectual property that includes service marks, trademarks, trade names, logos, trade secrets and copyrighted materials (e.g., operating manuals, product information sheets and advertising materials), in order to form an attractive business opportunity to potential franchisees. In order to protect franchisees from unfair competition, franchisors have always had federal copyright, trademark and trade dress infringement actions and state law trade secret and unfair competition actions as part of their legal arsenal for use in bringing suit against such competitors. This arsenal also includes state law breach of contract causes of action against franchisees who fail to “follow the rules” of the business model (i.e., failing to honor the obligations set forth in the franchise agreement and operations manual). In today’s economic and technological climate, however, one more option should be considered for inclusion in a franchisor’s arsenal — business method patents and the threat of a federal patent infringement suit against a terminated franchisee who continues to use the franchisor’s patented methodologies.

A Few Patent Law Basics

A patent is a grant by the United States federal government that entitles the owner (e.g., the individual inventor(s) or a company to which the inventor(s) assign their rights) to exclude others from making, using, selling, offering to sell, or importing into the United States an invention. The rights granted by a U.S. patent are enforceable only in the United States, and last a period of 20 years from the date on which the application was filed. (Almost every country in the world has its own patent laws, and thus patent protection must be separately applied for in the countries where a franchisor operates.)

According to the U.S. patent laws, a patent is granted to the first inventor of a novel, useful and nonobvious: (i) process (i.e., method); (ii) machine; (iii) article of manufacture; or (iv) chemical

compound. New and useful improvements of any of these four statutory classes of invention are also patentable. The U.S. Supreme Court has interpreted the patent laws to mean that “any [new, useful and nonobvious] thing under the sun that is made by man” is patentable.

What Are Business Method Patents?

“Business method patent” is not a legal term with a strict legal definition. As listed above, none of the four statutory classes of invention are called “business methods.” Rather, the term “business method patent” is a colloquial and generic term used to describe any patent whose subject matter arguably covers a method of doing business. Thus, herein, we refer to “business method patents” as those that cover a process, or some portion thereof, employed in the business model devised by the franchisor to be implemented by franchisees operating under a franchise agreement.

The recent public attention to business method patents can be traced to a 1998 decision by the U.S. Court of Appeals for the Federal Circuit — a specialized court whose jurisdiction includes appeals from all patent cases nationwide. The decision, *State Street Bank & Trust Company v. Signature Financial Group*, 149 F.3d 1368 (Fed. Cir. 1998), cert. denied, 525 U.S. 1093 (1999), involved the following invention:

[The] patent is generally directed to a data processing system . . . for implementing an investment structure which was developed for use in [the patentee’s] business as an administrator and accounting agent for mutual funds. In essence, the system, identified by the proprietary name Hub and Spoke®, facilitates a structure whereby mutual funds (Spokes) pool their assets in an investment portfolio (Hub) organized as a partnership.

Prior to *State Street*, there was some confusion as to whether an invention capable of being characterized as a “business method” meant that it was *per se* not patentable subject matter (*i.e.*, there was a “business method exception” to patentable subject matter). The Federal Circuit, while affirming that pure mathematical algorithms remain *per se* unpatentable, took the “opportunity to lay this ill-conceived [business method] exception to rest. . . . [B]usiness methods have been, and should have been, subject to the same legal requirements for patentability as applied to any other process or method.” The court went on to add that “[w]hether the claims are directed to [patentable] subject matter . . . should not turn on whether the claimed subject matter does ‘business’ instead of something else.” Rather, any method which can be described as a whole in a manner where it produces “a useful, concrete and tangible [*i.e.*, ‘real-world’] result,” is eligible for patent protection. The court found that the “useful, concrete and tangible result” achieved by the mutual fund-related patent in *State Street* was “a final share price momentarily fixed for recording and reporting purposes and even accepted and relied upon by regulatory authorities and in subsequent trades.”

The effect of the *State Street* decision has been to provide incentive (and validation) to inventors to file patent applications directed to inventions that previously fell outside the traditional notions of patentable subject matter. Popular subject matter of these non-traditional, business method patent applications include e-commerce applications in insurance, securities trading, health care management, reservation systems, electronic shopping, auction systems, catalog systems, incentive programs, redemption of coupons, banking, billing, point of sale systems, accounting and inventory management. In fact, the United States Patent and Trademark Office (PTO) experienced a doubling of such e-commerce related patent applications in the one-year period following the *State Street* decision.

Advantages to Owning Business Method Patents

If a franchisor has a portfolio of one or more patents in its arsenal, the overall value of the franchise is undoubtedly increased. Patents, business method or otherwise, also serve to add another layer to the intellectual property wall that protects the franchise as a valuable commodity in several ways.

First, adding patent protection to a franchisor’s existing intellectual property portfolio is attractive to potential franchisees. This is because patents enable the franchisor to protect its franchisees against competitors who compete unfairly by making, using, selling, offering to sell or importing into the United States without permission (*i.e.*, “infringing”) the invention. Consequently, franchisees would need permission (*i.e.*, a license under the patent) to practice the invention. Such a license would need to be included in the franchise agreement along with licenses to the other

intellectual property (*e.g.*, trademarks) related to the operation of the franchise.

Second, adding patent protection to a franchisor’s existing intellectual property portfolio is attractive as a method of controlling franchisees. The termination of a franchise will result in the loss by the franchisee of the right to use the patented business method, in addition to the loss of the right to use other intellectual property licensed under the franchise. Upon termination, which would revoke the patent license granted in the franchise agreement, if the franchisee does not voluntarily cease to use the patent, the franchisor can file a suit for patent infringement, seek damages (which might exceed the fees normally payable under the franchise agreement) and seek to enjoin the former franchisee from practicing the invention.

In both of the above-described situations, a patent allows the franchisor to have instant access to the federal courts which have exclusive jurisdiction over all patent infringement suits. This avoids having to file actions based on common law or state statutes in the state courts or having to deal with the tangles of corporate citizenship to obtain access to the federal courts via diversity jurisdiction.

Another advantage of owning a patent portfolio is that the franchisor has more options when seeking damages. For example, punitive damages are typically not available in commercial breach of contract actions filed against insurgent franchisees. In a patent infringement suit, however, treble damages are available upon finding that the infringement is willful. Injunctions and grant of attorneys’ fees and costs (in exceptional cases) are also available in patent infringement actions.

Yet another advantage of a patent infringement action is that the patentee may recover its lost profits, a reasonable royalty or a combination of lost profits and a reasonable royalty against the infringer. These available theories of damages may, in some cases, provide a more convenient economic model of damages for the franchisor to prove (and may yield larger damage amounts) than the expectation, reliance and/or consequential damage theories of recovery available in state law breach of contract actions.

Choosing a patent infringement suit over other causes of action in a franchisor’s arsenal has certain other procedural advantages. For example, the statute of limitations for a patent infringement action is six years. In comparison, the statute of limitations for state law breach of contract actions is typically four years. The six-year period is also longer than the three-year statute of limitations for copyright actions and that for trademark infringement actions. The federal trademark act has no express period of limitations and thus the courts borrow the relevant state statute of limitations (*e.g.*, four-year period for unfair trade practices).

Once a business method is considered likely to be patentable, it is important to consider whether the advantages of securing a patent for that method offset the disadvantage of public disclosure of the method (in exchange for the period of exclusivity on use of the method). If the method, once implemented, may be reverse engineered by competitors, public disclosure will not impair the value of the method to the franchisor. However, if the method would be difficult to reverse engineer, can be maintained as a secret when used in a franchise network and is likely to be of value for more than 20 years, it may be preferable to protect the method as a trade secret rather than make public disclosure and incur considerable cost in order to secure a patent.

Conclusion

There is no doubt that unless maintaining a novel business method as a trade secret is preferable to public disclosure, adding business method patents to a franchisor's arsenal has value. However, the patent laws and federal regulations are significantly different than those of other forms of intellectual property (*e.g.*, copyrights and trademarks) typically dealt with by franchisors. For example, the patent application process is significantly longer (*i.e.*, 2-3 years) and more costly than the copyright and trademark application processes. In addition, unlike copyrights and trademarks, patent rights can be lost if an application is not filed before the occurrence of certain normal, everyday business activities (*e.g.*, posting the invention on the franchisor's web site). Generally speaking, there is a one-year grace period in the United States from the time an invention is made public to when an application for patent must be filed. In most other countries, however, there is no such grace period (*i.e.*, a patent application must be filed in those countries prior to any public disclosure).

Given the above, it is important that franchisors seek competent legal counsel to obtain advice about the protection of novel and non-obvious business methodologies which are eligible for patent protection as soon as these methodologies are devised. Failure to move quickly to obtain patent protection for such methodologies *before* they are implemented or publicly disclosed may result in forfeiture of a franchisor's patent rights and lost opportunities for competitive business advantage.

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