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Where intellectual property and business law intersect with industry.

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In This Issue

Beware the "Accidental" Franchise

It is fairly easy to create an "accidental" franchise. For example, a manufacturer seeking to expand its business might enter into an agreement with a third party to sell or distribute its trademarked products only to find that the contract inadvertently meets the three-pronged Federal Trade Commission ("FTC") test for a franchise. And if it does, it could have very serious ramifications.

A commercial business arrangement is a "franchise" if it satisfies three definitional elements under the FTC Act regulations: the franchisor must (1) agree to provide a trademark or other commercial symbol, (2) agree to exercise significant control or provide significant assistance in the operation of the business, and (3) require a minimum payment of at least $500 during the first six months of operations. (There also are state franchise statutes to consider.) Thus, even if the parties sign a document identified as a license, lease or distribution agreement, if the relationship between them meets the three-part test, they may have created an "accidental" franchise that would subject the manufacturer to extensive federal and state franchise regulations, including the obligation to prepare detailed disclosure and registration documents; and that also creates potential rescission rights and leverage for poor-performing distributors.

By the time a business realizes that it has created an "accidental" franchise, it has already failed to comply with compulsory disclosure rules subjecting it to civil penalties (up to $10,000 for each violation), and may also find itself exposed to litigation risk when it seeks to end the contractual relationship. At a minimum, the discovery of a franchise law violation will mean that the manufacturer (the unintended franchisor) must devote resources to address the issue and avoid repeating its mistake in the future. This can be quite costly and highlights the need for careful drafting of documents by knowledgeable counsel to properly memorialize and describe party relationships.

An example of the problems that can arise when parties do not properly document their relationship can be found in the case of *Zotbelle, Inc. v. Kryolan Corporation* (U.S. Dist. Mass.1:17-cv-11411) where Kryolan was sued by its long-time business partner and distributor, Zotbelle, Inc. Zotbelle claimed that Kryolan breached a contract pursuant to which Zotbelle was to operate a store selling Kryolan-brand products in Boston, Massachusetts. The contract, which was prepared without benefit of counsel, was entered into after Zotbelle approached Kryolan about opening the store and, based on their past relationship, Kryolan agreed to do so and even provided Zotbelle with needed financial assistance by leasing the store and fully renovating it.

The store opened in late 2013. Kryolan terminated the parties' contract in mid-2016 when Zotbelle stopped making its required payments for rent and inventory. Zotbelle then brought suit for breach of contract, breach of the implied covenant of good faith and fair dealing, and fraud, alleging that it had operated the store as a Kryolan franchisee (even though Kryolan had no franchisees and no franchising program). It also claimed that the store failed because Kryolan did not deliver the level of support and assistance that it alleged Kryolan had promised and that Zotbelle claimed it was entitled to receive as a franchisee, despite the fact that the word "franchise" does not appear in the parties' contract or in any pre-contract emails or correspondence. Zotbelle also brought a claim for unfair and deceptive business practices under Massachusetts General Business Law, Chapter 93A, for the alleged failure of Kryolan to provide the disclosure documents required by the FTC Act franchise rules.

After approximately two years of litigation, the Zotbelle claims were all dismissed on summary judgment, and Kryolan was granted summary judgment on its claim for an unpaid loan that Zotbelle used to fund its Boston operation. The Court concluded that Kryolan did not breach the unambiguous terms of the parties' contract (Zotbelle alleged that there were some agreed-upon terms not reflected in the executed document), provided all the support it was required to give Zotbelle, and did not make fraudulent promises to induce Zotbelle to enter into a contract. While the Court found there to be issues of fact concerning whether a franchise relationship existed between the parties, and concluded that violations of an FTC regulation could state a claim under Chapter 93A for unfair business practices, it dismissed the Chapter 93A claim due to the failure of Zotbelle to establish a required elements of that claim – Zotbelle could not show damages or causation between the economic loss from a December 2014 loan by Kryolan's parent company and the failure of Kryolan to provide alleged FTC-required disclosure documents before the store opened in December 2013 to allow the Chapter 93A claim to go to a jury.

The fact that Kryolan was sued by a company with which it had conducted business for many years and with which it had a good relationship is instructive for companies considering the sale and distribution of branded products by third parties. The broad scope of franchise laws and the variety of commercial relationships that can fall within its regulatory scheme can be surprising to many. Drafting a proper license, lease or distribution agreement can prevent creating an "accidental" franchise relationship and protect the manufacturer should the relationship sour. It is certainly possible that the Zotbelle/Kryolan case could have been avoided entirely, or at least could have been concluded much earlier and with far less expense, if the parties had engaged knowledgeable counsel to prepare their initial agreement and thereby had avoided any franchise-related claims.

The State of Blockchain Patents

We previously reported on the possible applications of Blockchain for intellectual property protection. This article delves more deeply into companies protecting their Blockchain innovations through patents, and the considerations that go along with it.

Blockchain technology is steadily evolving from an open source software phenomenon into a thicket of patented inventions that utilize a Blockchain, which is essentially a decentralized and digitally distributed ledgering system created and operated using cryptography. A mid-2018 PwC survey found that nearly 84% of responding companies are actively investing in different industry applications of Blockchain technology.

It is reported that IBM invests around $160 million per year in Blockchain, and has some 1,500 employees working on more than 500 Blockchain projects in industries like shipping, banking, healthcare and food safety. Likewise, SAP announced a Blockchain technology hub, the Information Collaboration Hub for Life Sciences, which the company said could aid in keeping counterfeit pharmaceutical products off the market by creating a Blockchain application to allow a customer to scan a barcode on the product to verify its origin and authenticity. Businesses are expected to spend $2.9 billion on the technology in 2019, up almost 90% from 2018, according to the global data analysis firm IDC.

With the amount of money companies are investing in developing their applications of Blockchain, it is unsurprising to see the mass-proliferation of Blockchain patent filings across the globe. According to the Derwent World Patent Index, the earliest Blockchain-related patent application appeared in 2013, and as of April 30, 2019, there were roughly 14,035 Blockchain-related patent applications filed globally, roughly 50% of which were filed in China and 20% in the U.S. The U.S. to date has granted roughly 400 Blockchain-related patents. IBM, Microsoft, JPMorgan Chase, Bank of America, and MasterCard are among the top Blockchain patent application filers worldwide.

Of the over 150 patent applications IBM has filed, a handful of them have already been issued as patents, including one that describes the implementation of the decentralized ledgering technology to manage data and interactions for self-driving vehicles. In 2018, Walmart was awarded a patent for a system that would store a patient's medical records on a Blockchain after scanning a wearable device, reportedly based on Walmart's interest in acquiring the health insurer Humana. Thomson Reuters was also reported to have been awarded a patent for a Blockchain-based identity management system described as capable of receiving, validating and storing a user's identity using Blockchain.

As we see more Blockchain-related patents issued, there has been a lot of intrigue surrounding the way companies are going about exercising their mini-monopolies. Top Blockchain-patent filing companies often vow only to employ a strictly defensive patent strategy with their Blockchain-related patents, and are increasingly pooling their patents together with those of other patent-holders to develop their Blockchain technology and bring it into the mainstream more rapidly.

To better understand the current Blockchain patent environment, you need to go back to its 2008 origin as the technology underlying the Bitcoin cryptocurrency. Bitcoin's birth was announced, and its technology described, in a white paper published by a coder using the name "Satoshi Nakamoto", a pseudonym for an individual or group of individuals that have yet to be credibly identified. At that time, Bitcoin's Blockchain source code was released to the public and made available – unpatented – pursuant to a three paragraph open source license known as the "MIT License."

The MIT License grants permission to anyone, free of charge, to modify, merge, distribute, publish, or sub-license the software and distribute it under different terms than the ones in the MIT License, so long as the MIT License terms and copyright notice are affixed to all copies of the entire, or to substantial portions of, the original source code, including a broad disclaimer of any liability or damages on the part of the original developers. Thus, the terms of the MIT License apply to all future use of the original licensed source code, even though additional terms may apply to code derived therefrom or added thereto.

Open source code by definition is freely available to its users. Free Software Foundation (FSF) founder Richard Stallman explained that "freely available" means "freedom to use" and not "free as in beer" -- everyone has the ability to use, modify, and distribute their own versions of open source code, or to distribute as many copies of the original code as they want.

The Bitcoin Blockchain was exceeded in complexity by subsequent evolutions of Blockchain technologies, many of which also are available on an open source licensing basis. For example, the Ethereum Blockchain, which enables the use of "smart contracts" (the Bitcoin Blockchain does not) is available for use and further development pursuant to a somewhat more restrictive open-source license called the GNU General Public License v3 ("GNU GPL v3"), issued by the FSF.

The GNU GPL v 3 license goes further than the MIT License (and other permissive licenses like it, such as the BSD License), allowing anyone to use, modify, distribute, or sub-license an original copy of the covered source code or a modification of the source code derived from the original code, so long as the distributing user discloses to the subsequent user the source code of the original copy or the derivative work, and so long as the redistributor does so under licensing terms no more restrictive on future uses than the terms of the GNU GPL v3. This type of open source licensing, requiring any subsequent distribution to be subject to the same or less restrictions than the original covered code, is known as a "copyleft" because it serves the reverse function of a copyright by granting the perpetual right for others to use the software as opposed to restricting its future use.

Due to the array of open source licenses, varying in restrictions, under which source codes of Blockchain innovations have been released, IP lawyers advising companies that develop and patent their Blockchain innovations must be well versed in copyleft license requirements and the implications they have on exercising their patent rights. This is because some copyleft licenses include patent grant provisions that grant an express and perpetual patent license to all future licensees and distributors of the source code covered by the license.

For example, Section 11(3) of the GNU GPLv3 states that each contributor grants a subsequent user of a covered work a non-exclusive, worldwide patent license allowing the software to be used, sold, offered for sale, imported and otherwise run, modified and propagated subject to the subsequent user abiding by the GNU GPLv3 upon redistribution. Clause 1 of Section 11(2) goes even further to grant a patent license to future software patents held by the contributor. Additionally, if a licensee is issued a patent on a development that includes the licensed subject matter and the licensee sues a third party for patent infringement to try to stop another user from exercising its usage rights under the GNU GPLv3, the original licensee's license to use the covered source code is revoked automatically. In other words, whenever someone conveys source code covered by the GNU GPLv3 that they have copied or modified, they must provide the recipient with any patent licenses they would need to exercise the rights that the GNU GPLv3 provides, or they lose their license to use the underlying source code.

On the opposite end of the spectrum are Blockchain applications derived from open source code that was released to the public unlicensed in the first place, or under a permissive license like the MIT License. Such applications of Blockchain that receive patent protection require less careful consideration of how those patent rights may be exercised than do those derived from copylefted source code.

Embracing Blockchain's open source origins (and possibly seeking to avoid unnecessary entanglement with certain copyleft requirements), some companies such as the U.S. cryptocurrency exchange Coinbase, and the technology giant Blockstream, have already publicly pledged to use their patents for purely defensive purposes, meaning that they will not attempt to prevent others from using similar or even the same invention by suing to enforce their patent (i.e., using the patent offensively). In fact, some patent applications explicitly state that if the patent is granted, they intend to use the prospective patent only defensively.

This defensive approach has gained market acceptance because it maintains the interoperability and open source nature of Blockchain while providing sufficient protection from potential non-practicing patent assertion entities, i.e., patent trolls. Maximizing interoperability of this fairly new and intricate technology may be important because it increases people's familiarity with it and thereby decreases the amount of time it will take for Blockchain to appear in mainstream consumer channels – which is an ultimate goal of those investing in Blockchain, considering the amount of money that these businesses are expected to generate as a result.

The protection such patents provide against potential patent trolls is essential in the growing Blockchain industry. Indeed, patent trolls are now a well-established part American IP law, and their modus operandi in the Blockchain arena is the same: they amass as many inexpensive, broad, and widely applicable patents as cheaply as possible, and then they monitor the market closely to find infringers, obtain settlements and court damages, and extract licensing fees.

There is no doubt about the difficulties companies and lawyers face in protecting investments in Blockchain. With the predictions by many in the field of an impending patent war among Blockchain users, patent holders, and patent trolls, illuminating the winding path to protecting a company's Blockchain technology is increasingly important.

The Magic Phrase for Independent Contractor Agreements

One of the changes made by the United States Copyright Act of 1976 ("Copyright Act") with the most impact for business is the rule applicable to commissioned works. Most businesses engage independent contractors for services related to potentially copyrightable works such as graphic designs, photography or videography services, marketing materials, computer programming and web design. Often these engagements are informal and proceed on little more than the contractor's invoice. It is not often recognized that in the absence of the phrase "work made for hire", the contractor owns the copyright in the work even if the company paid for and commissioned it. Furthermore, in the absence of the phrase, if a conveyance of ownership of the copyright is secured through an assignment, this may not suffice to assure ownership of all rights throughout the full term of the copyright.

Under the Copyright Act, Section 203, the author, or specified statutory successors, may terminate a transfer of a United States copyright, or any right under copyright, effective thirty five years after the date of the grant. Termination under the statute may be effected not only as against the original transferee, but also subsequent transferees. Contractual provisions which attempt to abridge the termination right are unenforceable. 17 U.S.C. §203(a)(5).

The termination right is, however, subject to an important exception for "works made for hire", since as to these works the "employer" is the "author" and owns the copyright and all rights in it from the outset. 17 U.S.C. §201(b). Under the statute, a specially commissioned work by an independent contractor can be a "work made for hire" only if the parties expressly agree in a writing signed by both parties that it would be a "work made for hire," and only if it is a part of a specific kind of work, such as an audiovisual work, a compilation or a collective work. 17 U.S.C. §101.

Since 2013, businesses large and small, throughout the world, have run into problems when the statutory "work made for hire" writing requirement intersects with the Copyright Act termination provision.

The recent decision of the Second Circuit Court of Appeals in *Ennio Morricone Music, Inc. v. Bixio Music Group, Ltd.*, No. 17-3595 (2d Cir. August 21, 2019) ("*Morricone Music*") exposes the risk of termination lurking in agreements for the creation of copyrightable works with independent contractors both within and outside of the United States. Absent an express statement or writing that the work shall be a "work made for hire" within the meaning of the Copyright Act, ownership of the copyright in the United States may be subject to reclamation by the original independent contractor and his statutory heirs.

Morricone Music concerned the original music scores written by Ennio Morricone for six Italian motion pictures released in the 1970's and 1980's. Morricone, the Grammy and Academy Award winning composer of the scores for hundreds of motion pictures, created the scores pursuant to written contracts with Bixio, an Italian music publisher. The contracts required him to compose, arrange and conduct the orchestra for the movies. The contracts recited that "all rights of economic use" of the music were transferred to Bixio exclusively throughout the world "for the maximum duration under the laws applicable in each Country". The contract further provided that the soundtracks and orchestrations "shall forever continue to be the absolute and exclusive property of [Bixio] who shall be free to use them as [it] pleases at any time and in any Countries in the world." In 2012, Morricone served notice terminating the assignment of the U.S. copyrights for the music under § 203 of the Copyright Act.

The case presented the question whether the film scores were "works made for hire" for which termination was not available. In approaching the question, the Court noted that the contracts did not suffice to make the music "works made for hire" in accordance with the U.S. statute, because they did not expressly and literally recite that the scores would be "works made for hire."

Since the contracts did not provide expressly for the music's treatment as "works made for hire," the Court looked to the Italian copyright law to determine how it allocated copyright ownership among the parties. Finding that Italian law vested in the composer a "sole authorship" claim to the music he contributed to the film, which was contrary to the premise of the U.S. concept of a "work made for hire" where the commissioning party was the "author," the Court concluded that the film scores were not works made for hire and that the conveyance of the U.S. copyrights to Bixio was terminable under Section 203.

The contracts at issue in *Morricone Music* are typical of foreign agreements with independent contractors for the creation of copyrightable works. While some copyright statutes outside the United States identify the producer or commissioning party as the copyright owner for specific kinds of copyrighted works, such as sound recordings or computer programs, they do not have provisions which apply generally to the work of non-employee independent contractors comparable to the "work made for hire" provision of the Copyright Act.

The governing law differs in each country of the world. In civil law countries, copyright is considered an expression of individual personality and not merely as property. Moral rights – the rights to integrity of the work and attribution of authorship – can be inalienable. As a result, contracts in civil law countries typically assign only the economic rights incident to copyright ownership, while retaining the non-economic or moral rights. In Germany, conveyances of copyright ownership other than by inheritance are prohibited. In France, moral rights are inalienable, may not be transferred and continue to be owned by the heirs of the author, even after the work enters the public domain. Economic rights only may be licensed.

Common law countries like the United Kingdom and Australia may permit the commissioned author of a literary, artistic or musical work to freely contract away the entire copyright ownership. However, absent the express and literal statement that the work shall be a "work made for hire" for purposes of U.S. copyright law and that the commissioning party shall be deemed the author as well as the copyright owner for that purpose, even conveyance of the entire copyright will not prevent termination of the grant in the United States with proper notice.

Indeed, domestic businesses as well as foreign entities would be well advised to take heed of the court's view: the requirement of an express written agreement containing what it referred to as the "talismanic" phrase "work made for hire" is essential.

Update: Foreign Trademark Applicants and Registrants Must Be Represented By a U.S. Licensed Attorney

In our last issue, we discussed a proposed rule issued by the United States Patent and Trademark Office (USPTO) which would require all foreign trademark applicants and registrants to be represented by a licensed U.S. attorney. On August 3, 2019, the proposed rule did in fact become effective. It provides that trademark applicants, registrants, and parties to

Trademark Trial and Appeal Board (TTAB) proceedings domiciled outside of the United States must be represented before the USPTO by an attorney who is licensed to practice law in the United States. The rule does not extend to applications filed *pro se* pursuant to the Madrid Protocol.

For currently pending applications before the USPTO, office action responses will need to be filed by a U.S. licensed attorney regardless of when the application was filed or when the office action issued. For registered marks, a U.S. licensed attorney will need to file all materials relating to declarations of use and renewal. The TTAB will suspend any proceeding involving a foreign-domiciled party not already represented by U.S.-licensed counsel and will issue an order requiring such representation.

Welcome New Partner, Karen A. Monroe

Karen A. Monroe joined the firm in October as partner. Karen's international practice focuses on corporate and intellectual property law. Karen splits her time between the New York and Geneva, Switzerland offices.

Committees and Appointments

Alan Behr was appointed to the INTA Copyright Committee and **Monica McCabe** was appointed to the INTA Alternative Dispute Resolution Committee for the 2020-2021 term.

Congratulations

Alan Behr, **George R. Fearon**, **Helene M. Freeman**, **Thomas G. Jackson**, **Donald L. Kreindler**, **Marc A. Landis, Monica McCabe, Andrew J. Tunick** and **Lauren J. Wachtler** were selected for 2019 New York Metro Super Lawyers.

Alan Behr (Copyright and Trademark), **Helene M. Freeman** (Copyright), **Marc A. Landis** (Real Estate) and **Lauren J. Wachtler** (Commercial Litigation) were selected for 2020 Best Lawyers.

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