

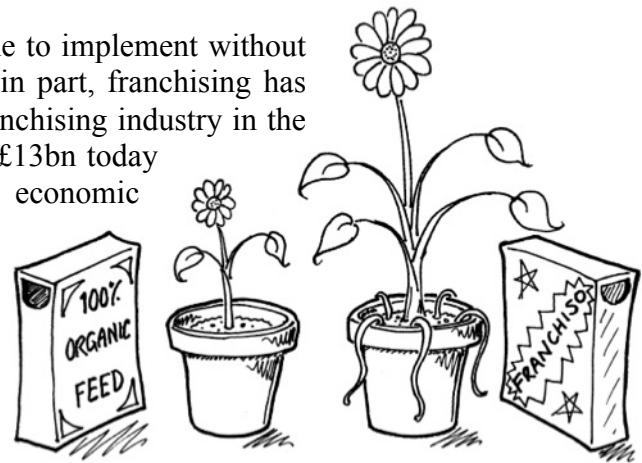
Intellectual Property and the Franchising Business Model

Recipe For Success

Franchising is a proven route to rapid expansion by taking a successful business in one location and replicating it across multiple locations or regions. Many entrepreneurs are attracted by the benefits of franchising and pursue a franchise business model as a way of growing their business more rapidly than conventional organic growth would otherwise support.

Franchise Industry Growth

The fundamental model is a relatively simple one to implement without risking large amounts of capital which is why, in part, franchising has proved to be so popular in recent years. The franchising industry in the UK has grown from £5bn 20 years ago to over £13bn today and is still growing. Given the straitened economic environment that has restricted the UK economy over the past several years, combined with the banks reining in small business lending, few industries have been able to boast such impressive growth.



Not Without Risks

There are pros and cons with all business models and franchising is not without its fair share of risks. Chief amongst these risks is the simple fact that as franchisor, the entrepreneur is entrusting the name, the brand, and ultimately the reputation of a successful business into the hands of his or her franchisees. If a franchised business is not successful for whatever reason then it could potentially harm the reputation of the franchisor's business and those of the other franchisees.

Licensing The Business

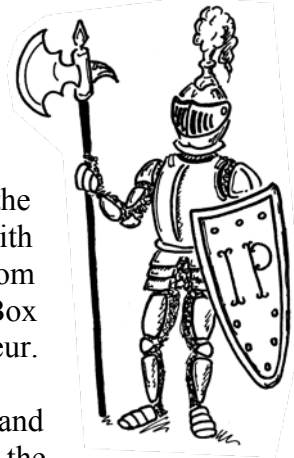
The act of franchising principally involves licensing the rights to use certain business assets from the franchisor's business to a franchisee's business. Typically this package of rights includes the franchisor's trade name, any related trademarks, and business systems. In exchange for the licensed rights, the franchisee agrees to pay, amongst other things, a running royalty to the franchisor usually expressed as a percentage of sales. In certain circumstances, the licensed package may comprise a bundle of rights including rights to use any other intellectual property (IP) owned by the franchisor.

Intellectual Property Protection

Given the risks inherent to a franchising business model, one way for entrepreneurs to mitigate risk and to protect their business is to seek formal legal protection for their intellectual assets. IP protection is afforded by law to inventors and creators of original works in recognition of the intellectual and financial investments required to create such innovations on the one hand, and the

relative ease with which they can be copied on the other. Certain of these legal rights are granted automatically at no cost (e.g. unregistered design rights and copyright) whilst others require formal registration at some cost (e.g. registered design rights and patent protection). Many small businesses can afford neither the time nor the cost of seeking formal registered IP protection, so the prospect of obtaining low-cost or no-cost IP protection can be particularly appealing.

IP rights afford protection not only for the franchisor's business but also the franchisees' businesses and the related licence revenue streams associated with those franchised businesses. In addition to protecting the business assets from being copied or used without permission, schemes such as the UK Patent Box also offer significant financial incentives to reward the innovative entrepreneur.



There is a broad range of IP protection available, both registered and unregistered, all of which comprise the intangible commercial assets of the business. Each form of protection, however, has its own merits and limitations, therefore combining such assets into an effective and sustainable business strategy requires a basic understanding of how each of these assets work in practice.

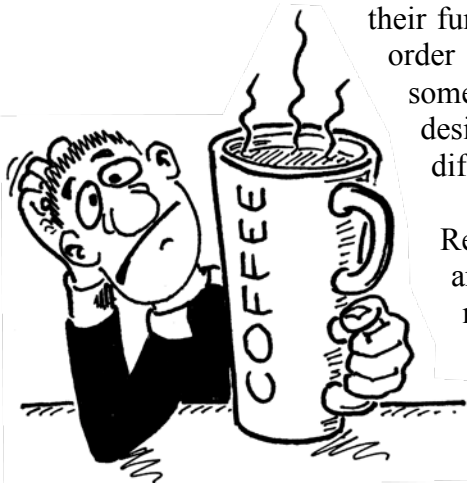
Design Right Protection

Many products have commercial value that is attributed to their shape or configuration, for example the shape of a new motor car or the next generation of smartphone. In the UK the law provides designers of original three-dimensional objects with automatic design rights protecting them from slavish copies. Provided there has been an actual act of copying by a third party and the designer is the rightful owner of the design, then the third party can be sued for design right infringement and prevented from making, selling, importing, or otherwise exploiting the article in question.

Design rights in the UK persist for ten years after the product is first marketed or fifteen years after its creation if the product is yet to make it off the drawing board. Unregistered design rights, as the name implies, require no formal registration and are granted by right to the designer at no cost.

Registered Design Rights

It is possible to register and protect the appearance of the whole or part of a product, including its shape, decoration, textures, ornamentation, etc provided the product features are not dictated by their function. The design can be either two or three-dimensional. In order to be valid a registered design must be new and possess something known as 'individual character'. In other words the design possesses something about its shape or appearance that is different from the norm or is eye-catching.



Registered design rights can persist for up to 25 years from filing and a third party can be sued for design infringement if they make, sell, import, or otherwise exploit articles that are 'confusingly similar' to the registered design in question. The legal test for infringement is literally no more than a visual side-by-side comparison of the article in question with the

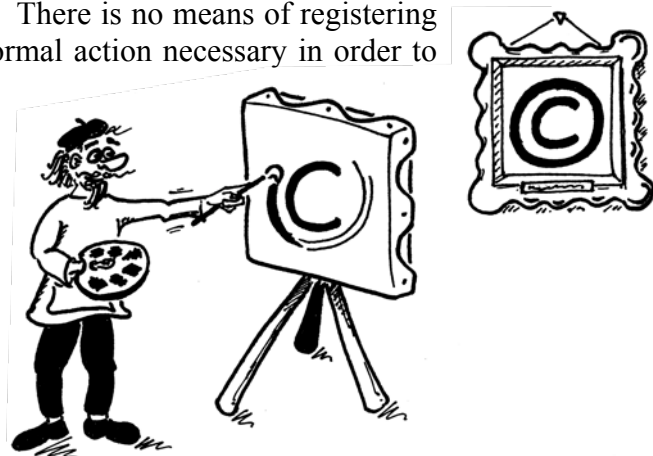
images filed on the design register. Unlike unregistered designs, there does not have to be an act of copying. The simple fact that the design was registered prior to the third party's use or exploitation of the design is sufficient to file a legal claim for design infringement.

Design registration is a straightforward, low-cost, and rapid means of securing enforceable IP rights to protect a company's designs. A franchisor can therefore seek protection through design registration for a product that may be specific to the franchise business, eg a new tool or a piece of equipment, in relation to the goods or services provided. No third party can then use or otherwise exploit products that are confusingly similar to the registered design without a licence from the franchisor. If a design is registered at the European designs office (OHIM) rather than the UK designs office (UKIPO) then one single design registration grants the owner a 25-year monopoly to use and exploit the design in all 28 member states across the European Economic Community.

Copyright Protection

Any written documents, drawings, sketches, promotional materials, images, instruction manuals, training documents, product brochures, service booklets, or similar original written or recorded works are automatically protected by copyright. There is no means of registering copyright in the UK and likewise there is no formal action necessary in order to

effect the legal right. Copyright of itself does not protect the idea or concept, it simply protects the precise way in which the idea is expressed – either the words or drawings that are used to communicate or convey the idea. An immense range of material is therefore covered by copyright protection at no cost to the originator. Copyright also lasts for a long time – the lifetime of the originator plus 70 years.



As with unregistered design rights, an actual act of copying has to have taken place in order for there to be an act of copyright infringement. If the franchisor wins an infringement action then the court can award an injunction to prevent further infringing acts, award damages to recompense the franchisor and/or franchisee, and order delivery-up or pulping of the infringing materials.

Unregistered Trademark Protection

Trademarks are usually associated with words or two-dimensional symbols or a combination of the two, e.g. trading names, slogans, logos, etc. In fact trademarks include any sign capable of being represented graphically, and also extend to marks with three-dimensional shapes or can consist of a distinctive colour, sound, or smell. It is permissible under UK law to use a trademark without registration by using the 'TM' symbol, even a mark that is not otherwise capable of registration because it may be descriptive of the goods or services being traded.

Unregistered rights also extend to the colour and style of packaging and the type of lettering used – the so-called 'get-up'. Get-up includes anything from the visual impression of business premises to the colour of employees' uniforms – in fact, reputation extends to *all* peripherals associated with the

goods or services being traded. Trademark protection is therefore particularly important to the franchising business model.

Use of an unregistered trademark through advertising or the sale of goods or provisions of services generates goodwill and reputation for the mark. Such reputation can sometimes just be localised to a particular trading area depending on where the business operates and/or advertises. If a mark or get-up has been used long enough to establish reputation, the franchisor can stop a competitor from ‘passing-off’ goods or services as if they originated from the franchise business by use of identical marks or get-up. As with other unregistered rights, unregistered trademark rights are available at no cost – they are acquired over time through use of the mark in association with the goods being sold or services being provided.

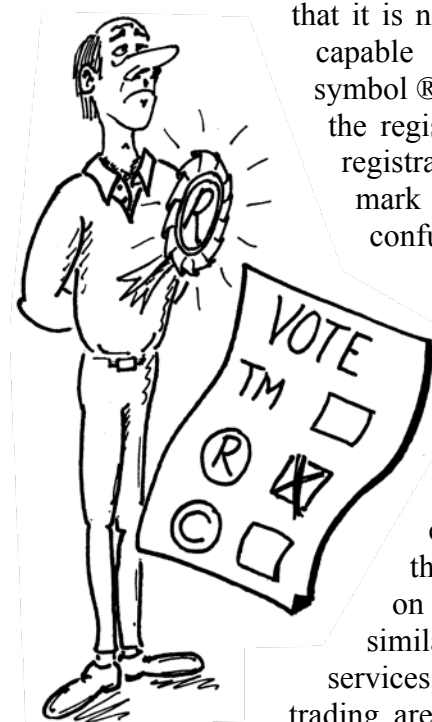
Trademark rights remain enforceable for as long as they continue to be used, they therefore form an essential element of any business strategy going forwards. In particular, owing to the fact that unregistered trademarks are not formally registered or available for inspection, it is equally important to ensure that a new franchise has freedom to use a trading name or slogan before trading in a new area.

It can be a very costly exercise to rename or rebrand a business if a third party has an established reputation, in the same market and the same area, and claims prior rights to any related unregistered trademarks that are confusingly similar to those of the new franchise. If a strong reputation exists in a certain trading area using a similar trading name, for example, then the franchisor may have to change its own trading name or avoid trading in that area altogether.

Registered Trademark Protection

Provided a mark is distinctive and capable of indicating the source of the goods or services being traded over those of the competitors (i.e. the mark represents a badge of origin) then, provided also

that it is not descriptive of those goods or services, the mark is potentially capable of registration. A registered trademark is marked with the symbol ®. Once registered the franchisor can prevent anyone from using the registered mark in relation to the goods or services specified in the registration. The franchisor can also stop the use of the same or similar mark on similar goods or services where such use is likely to cause confusion in the marketplace.



If a franchisor wins a trademark infringement action, then the court can award an injunction against further misuse of the mark, destruction of the infringing materials, and damages or an account of profits as compensation.

Registered trademarks can be renewed indefinitely provided they continue to be used in relation to the goods or services for which they were registered. The registration can, however, be challenged on the grounds that a third party has prior unregistered rights to a similar mark resulting from a strong reputation for the same goods or services, even if that reputation is limited to being only within a certain trading area. If successful, the trademark registration would be cancelled

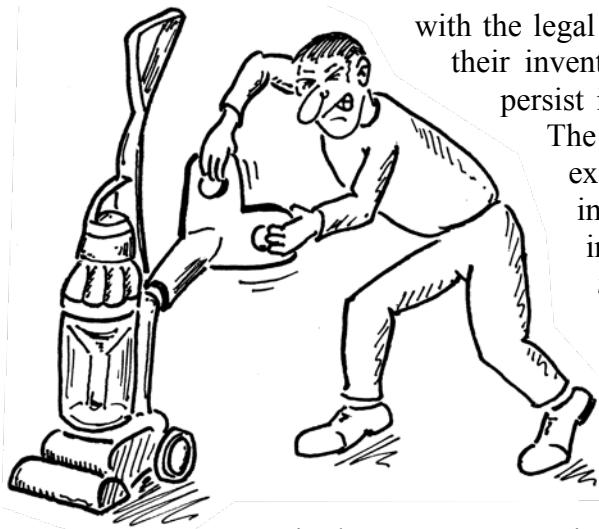
from the register. The franchisor therefore needs to consider carefully any existing regional reputations attaching to similar businesses before investing in registered trademark rights of his or her own.

Patent Protection

Most people will be generally aware of patents and their association with inventions. They may have encountered patents at one time or another in relation to anything from clockwork radios to

domestic vacuum cleaners. Patents fundamentally provide inventors with the legal rights to prevent others from working or exploiting their invention for 20 years from the filing date. The rights persist in each country for which there is a granted patent.

The invention itself can be an improvement of an existing product or piece of apparatus or an improvement over an existing process. Provided the invention itself is *novel, not obvious*, and has *industrial application* then it is capable of being protected by a patent.



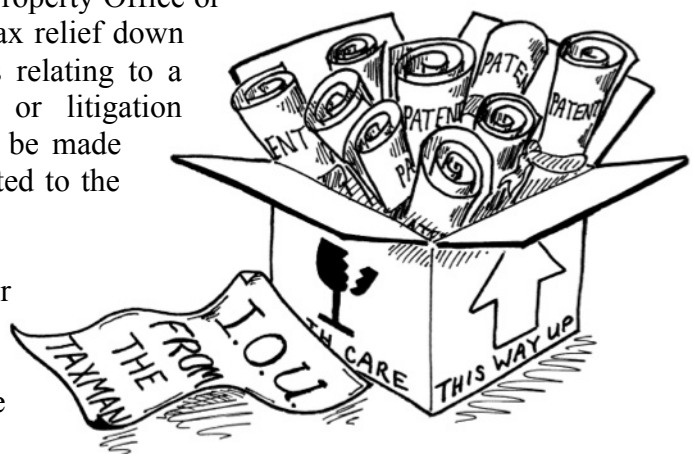
Many people view patents as the ultimate means by which inventors can protect their inventions. This view certainly has some merit, particularly given the investments of time and money that are required to secure patent rights in the first place. Such investments, however, are often sufficient to deter many small businesses from seeking patent protection, particularly when there is no guarantee that a patent will be granted at the end of it or indeed what commercial protection it will ultimately provide.

However, where the franchise business model is concerned, there is perhaps now a renewed interest and financial motivation for seeking patent protection beyond the attached legal rights – qualification for corporation tax relief on related profits under the UK Patent Box.

UK Patent Box

The UK Patent Box is HMRC's very own tax saving scheme and it went live in April 2013. Any companies paying UK corporation tax can potentially benefit from the scheme if they own and work a patent granted by the UK Intellectual Property Office or European Patent Office. The scheme offers tax relief down to 10% for any qualifying worldwide profits relating to a patented invention, including any licence or litigation revenues. Any claim for tax relief can only be made after a patent is granted, but it can be backdated to the date on which the patent application was filed.

The benefit applies to all profits relating to or utilising a patented invention even where the invention itself is only a single component in a larger system or a single step in a more



complex process. Any revenues that the franchisor receives by way of royalties or licence fees from franchisees related to the patented invention will therefore benefit from tax relief under the scheme. So if the franchise business relies on the use under licence of a patented invention, such as a piece of apparatus or a particular process, then all licence income flowing to the licensor will potentially fall within the Patent Box.

In Summary

IP and the franchise business model are inextricably linked. IP protection offers franchisors a way to protect their business's intellectual assets from being copied or exploited without a licence and therefore mitigate the commercial risks inherent to pursuing a franchise business model.

Certain IP rights are acquired automatically as a consequence of operating the business, whereas other IP rights require the owner to undertake a formal process of application and registration. Of particular relevance to franchisors are low-cost or no-cost forms of IP protection, namely designs, copyright, and trademarks.

Recent changes in UK Corporation Tax have created a renewed interest in seeking patent protection in order to benefit from a reduction in corporation tax on IP-related profits. So whether it is for business protection purposes or financial gain, IP offers entrepreneurial franchisors the assets with which to implement, execute, and ultimately realize value from their business strategy.

Useful References

The UK Intellectual Property Office (www.ipo.gov.uk)

The Office for Harmonization in the Internal Market (OHIM) (www.ohim.eu)

The European Patent Office (ep.espacenet.com)

World Intellectual Property Organisation (www.wipo.int)

The United States Patent and Trademark Office (www.uspto.gov)

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