Aspen Publishers

May 2009

DEVOTED TO LEADERS IN THE INTELLECTUAL PROPERTY AND ENTERTAINMENT COMMUNITY

VOLUME 29 NUMBER 5

The Licensing Journal

Edited by the Law Firm of Grimes & Battersby

Wolters Kluwer
Law & Business

Licensing Against the Wave of Franchising—Avoiding the Hidden or Inadvertent Franchise

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Franchising is a popular method of distribution used by a wide variety of businesses. Franchising is attractive as a business model because it offers companies the prospect of expansion with a lower financial and overhead investment than establishing or acquiring a network of company-owned distribution points. In short, franchising leverages other people's money, credit, and personnel to establish and operate new branded locations. Not coincidentally, franchising also happens to be regulated under federal law and the laws of approximately half the states. Unless an exemption exists, a franchisor must bear significant compliance expenses and adopt robust compliance procedures. For branded businesses interested in increasing distribution, a common reaction when faced with the prospect of complying with the franchise laws is to say that they will just "license," rather than "franchise." While the goal of franchise avoidance may be simple, the execution is not.

With an awareness of the franchise laws and careful planning, licensors can attempt to structure licensing arrangements to avoid being deemed franchisors, depending on what features are important in their business model. Without an appreciation of the franchise laws, however, a licensor risks creating "hidden" or "inadvertent" franchises. This article provides an overview of why it matters if a license is deemed to be a franchise and briefly describes the franchise disclosure and registration scheme and franchise relationship laws. It discusses several cases to illustrate that distinguishing between licenses and franchises is not just an intellectual exercise, but has serious practical consequences. These cases also demonstrate how a license agreement may be uncovered as a "hidden" franchise years after its initial adoption and use. Finally the article reviews the definitional elements of what must be present to constitute a "franchise" and offers some advice on structuring a license to avoid falling under the franchise laws.

Why It Matters—the Regulation of Franchises

Starting with California in 1970, 15 states adopted franchise disclosure laws to address fraud in the industry.[1] The Federal Trade Commission (FTC) adopted the FTC Rule, a national disclosure requirement effective in 1979.[2] These laws treat the offering of franchises similarly to the offering of securities and require disclosure to the prospective franchisee prior to the franchise sale in a prescribed format now referred to as a Franchise Disclosure Document (FDD).

The FDD contains 23 items of information about the franchisor, including the history of the company and certain predecessors and affiliates, biographies of key management personnel, litigation and bankruptcy histories of the franchisor and key management personnel (including the disclosure of terms of settlements even if the parties intended the settlement agreement to be confidential), descriptions of the franchised business, the fees, investment costs, advertising and training programs, the revenue the franchisor and its affiliates record each year from sales of goods and services to franchisees, supplier rebate programs, territorial rights, restrictions on sourcing inventory and equipment used in the business, key agreement provisions, optional financial performance representations, and a three year history tracking the number of company and affiliate-owned and franchised units, including information on transfers and terminations and non-renewals. The FDD must contain audited financial statements, lists of current franchisees and franchisees that transferred or closed a unit or were terminated during the last fiscal year, and the table of contents of the franchisor's operations manual (or the franchisee prospect must be given access to the operations manual). There are strict limitations on what can be said about the financial performance of units in the franchise system. Any financial performance representations or earnings claims must be contained in the FDD.

A franchisee prospect must receive the FDD generally at least 14 calendar days before the prospect can sign the franchise agreement or pay money to the franchisor or its affiliates. The prospect also must know what the signature version of the franchise agreement will look like for at least seven calendar days except for changes to standard forms the prospect negotiates with the franchisor.

All but one of the 15 franchise disclosure states also requires annual registration of the offering or a notice filing with the state. No filing is required under the FTC Rule. Most of the registration states are authorized to review the FDD and request changes. Several of the states review offerings vigorously and routinely issue deficiency letters with comments, which must be cleared before the FDD can be made effective in their states. The FDD must be updated annually, and amended or supplemented during the year if there are material changes. Most of the registration states require amendments to be filed. During the annual renewal process and any amendment process, there is usually a blackout period in one or more states when the old FDD is no longer effective and the new FDD has not been declared effective, preventing the issuance of current FDDs to prospects and the closing of franchise sales, which franchise salespersons naturally find frustrating.

Preparation of the FDD, monitoring any changes in the information reported that might necessitate an amendment, annual registration of the FDD with the registration states, filing any required state notice, and instituting a compliance program to make sure all prospects receive the FDD and final forms of agreements within the right time periods and the franchisor complies with other requirements of the franchise law, represent an investment of money and time by the franchisor. Adding to the burden of compliance, the franchise laws are not the only source of a potential regulation. Various business opportunity laws overlap with franchise laws and need to be reviewed as part of the franchise analysis of a transaction. The FTC and about half the states have enacted business opportunity laws, which require disclosure and usually a state filing. Fifteen states include franchising activities within the scope of their business opportunity laws, but often exempt franchises if the franchisor complies with the FTC Rule or provides a marketing plan in conjunction with a federal trademark, or in a few states, even a state trademark. In some states the exemption is automatic, but in others the franchisor must file for the exemption, including Connecticut, Florida (annually), Kentucky, Nebraska, Texas, and Utah (annually). If a marketing plan is provided in conjunction with a trademark but the trademark is not yet registered, registration of the offering or establishment of a bond or escrow to secure the franchisor's performance, or other action may be needed in several states, including Connecticut, Georgia, Maine, North Carolina, and South Carolina. Business opportunities are outside the scope of this article, but should be addressed.

The burdens of complying with the franchise disclosure and registration requirements are not insurmountable, as evidenced by the thousands of franchisors operating in the United States. The costs are significant enough, however, to create a barrier to launching or maintaining a franchise program, and explain the temptation by licensors to consider their existing or prospective agreements just a "license," rather than a "franchise."

While the cost of compliance with the franchise disclosure and registration requirements is high, the cost of non-compliance often proves to be much higher. Failure to comply with the FTC Rule and state franchise disclosure and registration laws can lead to FTC or state enforcement, criminal charges, fines, and the recovery of monies on behalf of the franchisees as consumer redress. The FTC and the states also may require rescission of the franchise agreement, requiring the return of all payments made by the franchisee and cancellation of the franchise agreement. There is no private right of action for violation of the FTC Rule, but violation of the FTC Rule is an unfair and deceptive trade practice under Section 5 of the FTC Act, which may provide the basis for a claim under a state "little FTC Act" or unfair trade practices law. Failure to provide the disclosure required in the FDD also may lead to misrepresentation or fraud claims. Franchisees have ample remedies under state law for damages, often with treble damages possible.

Franchises are regulated in another manner by franchise relationship laws in approximately 23 states, including some of the states with disclosure laws. Some states also have industry-specific laws for the protection of automobile dealers, farm and equipment dealers, and wine and liquor distributors. The state franchise relationship laws are intended to protect franchisees from potential abuses of power by the franchisor who is assumed to be the larger, dominant party in the relationship.

Most of the state relationship laws include limitations on the franchisor's right to terminate or not renew a franchise agreement, imposing "good cause" requirements, mandatory notices of default and minimum cure periods, and obligations upon termination of the franchise to purchase inventory or other items required by the franchisor. Some relationship laws address the right of the franchisee to transfer the business and to pass the business on after death to family members, the right to associate with other franchisees, the imposition by the franchisor of substantial changes in the competitive circumstances of the relationship, discriminatory treatment of franchisees, and other matters.

Failure to follow the state-imposed procedures for terminating or not renewing a franchise is an area of great exposure for licensors. Damages often are high, and may be subject to trebling under state law. In some states it is easier for a licensor to be a franchisor under the franchise definition for purposes of the state relationship law than under the FTC Rule or state disclosure and registration laws. A licensor must take care when terminating any licensee who is using the brand's mark in the distribution channel, whether it is an operator of a brick and mortar store, a distributor, or a sales representative. All of them are potential "franchisees" under the state relationship laws. Violation of other aspects of state relationship laws also create exposure to damages claims, including treble damages.

Uncovering "Hidden" Franchises

The risk of "accidental" or "hidden" franchises became apparent with the adoption of the first franchise laws. As parties to various forms of licensing arrangements tested the coverage of the various franchise laws, gray areas quickly emerged surrounding the elements needed to find a "franchise" under the FTC Rule and state franchise laws. A lack of uniformity among the franchise laws and a wide diversity of economic activity added to the uncertainty.

Businesses learned over time to submit their new business offerings to legal review in order to determine if they fell under the coverage of the various franchise and business opportunity laws. As new offerings were evaluated, awareness grew that certain business structures warranted particularly careful review. These offerings came to include (1) licenses, including trademark, patent and software licenses, (2) distributor, dealer or sales agent agreements, (3) joint ventures, limited partnerships and business networks, and (4) co-branding relationships.

The full extent of risk became apparent when long-standing relationships never considered franchises began to come under challenge and, in a good number of cases, declared franchises. When something went wrong in a "licensing" relationship, putative franchisees and their attorneys attempted to uncover previously "hidden" franchises. The triggering event was often an attempted termination by the licensor and/or business failure of the licensee. Facing termination or financial loss, putative franchisees went on the offensive and claimed protection under various states' franchise relationship laws, which in many cases limit a licensor's termination rights.

Examples of Long "Hidden" Franchises

A number of cases underscore the possibility that franchise laws can be applied in long-standing relationships, never previously considered by the parties to be a franchise, if the facts satisfy the definition of franchise under the applicable law. The three cases described below demonstrate the real life consequences when previously "hidden" franchises are uncovered.

The Girl Scouts organization was founded almost one hundred years ago in 1912. In 1950, the national organization was incorporated under an act of the United States Congress. Also in 1950, a local Girl Scout council was chartered by the national organization in Wisconsin. Almost 60 years later, in September 2008, the Girl Scouts of Manitou Council, Inc. convinced the US Court of Appeals for the Seventh Circuit, after losing in the District Court, that the local council was a "dealer" under the Wisconsin Fair Dealership Law, entitled to the protections under the law against terminating dealers without good cause. The Court granted the local council a preliminary injunction preventing the national organization from taking away more than half of the local council's jurisdiction because the local council objected to a proposed consolidation of territories and refused to sign the merger papers.[3] The Wisconsin Fair Dealership Law had been enacted in 1974. It includes a broad category of sellers, encompassing franchisees, who are granted the right under an agreement to sell or distribute goods or services or use a grantor's trademarks, provided that a community of interest exists between the parties in the sale or distribution of the goods or services.

The *Girl Scouts of Manitou Council, Inc.* case raises the possibility that other similarly structured non-profits with an umbrella national organization licensing the trademark to local organizations could be challenged under state relationship laws even years after the local chapters were established. Non-profits are specifically excluded under the FTC Rule, but aren't necessarily excluded under state laws.

Nationwide Insurance was founded in 1925. Alex Charts became a sales agent for Nationwide in 1979. Mr. Charts was terminated by Nationwide in 1996. He brought suit in 1997, and in December 2004, a Connecticut jury in a federal court awarded him $2.3 million in damages, including for wrongful termination under the Connecticut Franchise Act, which had been enacted in 1972. The jury found that the relationship was a "franchise" under the Connecticut Franchise Act. The award was ultimately reversed but not for any reason involving the Connecticut Franchise Act. Rather, it was determined that Mr. Charts did not own the claim for wrongful termination personally. The claim belonged to his entity that filed bankruptcy, and the claim should have been part of the bankruptcy estate.[4] After the jury award, the case generated a lot of discussion regarding whether insurance companies would start to treat their sales agents, particularly their exclusive sales agents who only sold that company's products, as franchisees. Insurance companies did not embrace the notion that their sales agents could be deemed franchisees. Insurance sales agents had claimed protection under the franchise laws before the *Charts* case, and since, but have not been successful.[5] The *Charts* case may be an anomaly, but the $2.3 million jury award for wrongful termination illustrates the magnitude of the risk for being wrong about whether or not a relationship is a franchise. The Connecticut Franchise Act does not require the payment of a fee as an element of the definition of franchise, which made the sales agent's franchise claim somewhat easier. Sales agents usually do not pay fees in order to act as sales agents.

The third case involved a "hidden" or "creeping" franchise fee. To-Am Equipment Co., Inc. became a dealer for Mitsubishi Caterpillar Forklift America, Inc. in 1985. To-Am was terminated by Mitsubishi in 1994. To-Am brought an action in 1995 alleging wrongful termination of franchise without cause. A jury awarded To-Am $1.525 million in damages, finding that the relationship was a franchise under the Illinois Franchise Disclosure Act. *To-Am* is a very interesting case, especially considering that one strategy to avoid coverage of the franchise laws is to eliminate an element of the franchise definition, such as a franchise fee, discussed below. In *To-Am* the court held that the aggregate cost of purchases of parts and service manuals totaling $1,659 over nine years was sufficient under the Illinois Franchise Disclosure Act to reach a $500 fee threshold under the franchise definition. There was no time limit to meet the fee requirement as there is under the FTC Rule (six months).[6] *To-Am* illustrates how important it is to consider all payments made by a licensee to a licensor when checking to determine if there are any fees. *To-Am* cautions that it may be better to be safe than sorry, and to resist the temptation to charge even minor fees during the license relationship.

The Elements of a "Franchise"

Under applicable federal and state law, a franchise, by definition, involves a trademark license.[7] However, not every trademark license is a regulated franchise. A franchise is a trademark license, plus one or two other factors as discussed below. All the elements of the statutory definition must be present in order for the relationship to be a regulated franchise. Elimination of at least one of the elements of the franchise definition relieves the licensor from the burden of complying with the franchise laws.

There is no uniform definition of a franchise under the FTC Rule and the laws of the various states. Most jurisdictions provide for exemptions from registration and/or disclosure, and the exemptions under the FTC Rule and state laws also are not uniform, though there are some exemptions that apply in several jurisdictions. Each fact situation has to be analyzed under the FTC Rule, which applies everywhere in the United States, including its territories and possessions, and each potentially applicable state law, because the results may vary.

There are three basic elements in the definition of a franchise under the FTC Rule:

1. The right to use the franchisor's trademark, either in connection with the operation of a business (a package franchise) or in connection with the sale or distribution of goods or services (a product franchise);
2. Significant control over or significant assistance in the franchisee's method of operation, by the franchisor; and
3. The payment of a required fee to the franchisor or an affiliate of at least $500 paid before or within six months after the business commences.

The various definitions of a franchise under state laws generally include three basic elements, including some variation of the trademark and fee elements under the FTC Rule, and substituting a "marketing plan" or "community of interest" element for the "significant control or significant assistance" element contained in the FTC Rule as the middle element. State law franchise definitions generally include:

1. The right to offer or distribute goods or services either (a) "substantially associated" with the

franchisor's trademark, or (b) "using" the franchisor's trademark;
2. Either (a) a "marketing plan" or system prescribed, or suggested, in substantial part by the franchisor, or (b) a "community of interest" of the franchisor and the franchisee in the marketing of goods or services; and
3. A franchise fee.

Some level of franchise fee is required as an element of the franchise definition under all the state disclosure laws, but some state relationship laws, including those in Connecticut and New Jersey, do not require the presence of a fee in order for the law to apply.

New York's disclosure law has broader application than the other states' laws because New York requires the presence of only two of the three elements. A franchise fee is required but it can be paired with either a marketing plan or substantial association with the franchisor's trademark. Because there is so much emphasis on promoting a brand, a marketing plan will usually involve a trademark, although technically New York law can cover more situations by requiring either factor instead of both. New York's law is important because New York is an important center of commerce where many potential licensors and licensees are headquartered. The need to provide disclosure and register in New York apply no matter where in the world the franchise is located if the transaction is subject to the New York law, either because the offer is made in or accepted in New York or if the parties discuss the transaction in New York. Many, but not all of the disclosure states have exemptions from coverage of their law if the franchisee will conduct business out-of-state. The FTC has recently confirmed that it will not enforce the FTC Rule if the franchise will not be located in the United States. New York has not ceded any jurisdiction of its law.

Attempting to Avoid the Franchise Laws—Eliminating a Franchise Element from the License

The franchise laws apply only if all of the required elements of the franchise definition are present. One way to defeat coverage is to eliminate one of the required elements from the distribution program. Another way is to look for an exemption from coverage, with great care exercised in determining if the exemption is from state registration, disclosure and/or franchise relationship provisions. Disclosure is often required, even if the transaction is exempt under a state registration law. State relationship laws generally have broader coverage and fewer exemptions. Exemptions are discussed more in the next section.

To eliminate one of the three elements of a franchise, (1) trademark license, (2) control/assistance/marketing plan/community of interest, and (3) a fee, it is necessary to understand some of the issues surrounding each.

The Trademark License Element

The trademark license is the hardest element to eliminate. In a "package" franchise, also known as a "business format" franchise, the whole point of adding more units is usually to build the brand name. In a package franchise, the licensee duplicates the licensor's business, almost always offering the same goods and/or services under the licensor's trademarks and trade dress, following a system of operation designed to achieve uniform quality standards and make sure the "package" of goods or services delivered to the customer, whether it is a sandwich, an oil change or temporary personnel services, provides the same customer experience everywhere. It may be desirable in limited circumstances to clone the licensor's operation but allow the licensee to use a mark selected by the licensee. These circumstances include a limited period to test whether the concept is franchiseable, meaning whether it can be replicated and the knowledge transferred to allow a third party to operate the new unit successfully. Another instance would be if the licensor doesn't intend to expand to a certain territory and wants to earn a return from licensing the know-how gained from its development of the concept. Both circumstances avoid the costs of franchise law compliance and don't establish the licensee as a future competitor of the licensor's units. There is a risk of losing control over the non-trademark intellectual property, but this is a risk inherent in many licensing arrangements.

In the second form of franchising, product franchising, it is not as important that the licensee operate under the trademark of the licensor. There is more flexibility to downplay the licensor's mark in a product franchise. The product franchise often enables the licensor to distribute its goods by licensing business outlets to sell the goods using the licensor's trademarks. The product franchise focuses on the sale of the licensor's products and not the establishment of a uniform system of outlets. But promotion of the brand is usually important, and this would usually satisfy the trademark element of the definition. If the licensee expressly is prohibited from using the trademarks except for the appearance of the marks on the licensor's goods, and the trademark is not communicated to the licensee's customers, the element of either substantial association with the trademark or a license to use the trademark may not be satisfied.[8] Distributors and sales agents also are likely to operate under their own names, but the same issue arises concerning their responsibility to promote the brand.

The Control Element

The FTC Rule element of significant control or significant assistance and the state variations of a "marketing plan" or a "community of interest" are all considered evidence of some form of control by the licensor over the licensee. The FTC Staff equates "control" and "assistance" to the "marketing plan or prescribed approach" used by a majority of the states.[9] The draft Compliance Guide issued by the FTC for the 2007 revision to the FTC Rule states that "the control or assistance must relate to the franchisee's overall method of operation—not a small part of the franchisee's business" in order to be significant. The focus is on the degree the franchisee must rely on the franchisor. The more experienced the franchisee or the broader the scope of the franchisee's total operations, the less significant the control or assistance is. Conversely, the more the control or assistance is unique to the specific licensor, compared to a practice employed by all businesses in the same industry, the more it is significant.[10] This is consistent with the fractional franchise exemption, discussed below, which seems to provide a safe harbor that quantifies the experience and importance in the overall scheme of the licensee company when the control or assistance is not deemed significant.

The FTC considers the following to be significant types of control:

- Site approval,
- Site design or appearance,
- Hours of operation,
- Production techniques,
- Accounting practices,
- Personnel policies,
- Promotional campaigns requiring franchisee participation or financial contribution,
- Customer restrictions, and
- Area of operation

The FTC considers the following to be significant types of assistance:

- Providing formal training,
- Establishing accounting systems,
- Providing management,
- Marketing or personnel advice,
- Selecting sites,
- Furnishing systemwide networks and Web sites, and
- Furnishing a detailed operations manual

Also to be considered, but not as important, are a requirement that the franchisee service or repair a product (except warranty work), inventory controls, required displays of goods and on-the-job assistance with sales or repairs. Furnishing point-of sale advertising displays, sales kits, product samples, and other promotional materials to a distributor, or conducting radio and television advertising whether provided solely by the franchisor or on a cooperative basis with franchisees, are all not considered significant if other assistance is not provided.

The FTC has addressed concerns that the need to police the trademark under the Lanham Act and other laws and providing certain business arrangements always will constitute significant control under the FTC Rule. As a matter of FTC policy, the FTC will not consider trademark controls designed solely to protect the trademark owner's legal ownership rights in the mark (such as display of the mark or right of inspection), health or safety restrictions, arrangements for provision of credit cards or credit services, and assistance to distributors in obtaining financing to constitute significant control.[11]

The analysis of the state elements of a marketing plan or community of interest are similar to the FTC approach, and very fact specific. Under each formulation of the control element, the facts must be reviewed carefully on a case by case basis. Whether or not the control element has been eliminated from a business arrangement often is not black or white. A decision to go forward treating the relationship as a license and not a franchise must usually be made based on risk assessment.

The Fee Element

Eliminating the fee element often is considered the most reliable way to avoid application of the franchise laws. Structuring the distribution program without any fees paid by the licensee for the right to use a business model offers the clearest and most objective path compared to the issues surrounding whether or not the license or control elements are present. Use of this strategy must include careful monitoring of the business relationship to make sure no fees or charges are introduced that could jeopardize the result. Initial and ongoing royalty fees almost always are important to the licensor in the package or business format franchise.

If the licensor is using the licensee to distribute the licensor's products or services to the marketplace, as in a product franchise or traditional distributorship so the licensor is receiving revenue from the product or services sales, the licensor has established its revenue stream and has less need to obtain other fees from the licensee. As noted in the *To-Am* case discussed above, for the privilege of charging a distributor $1,659 over a period of nine years for manuals, the licensor had to pay $1.525 million in damages, because the little charges added up to a franchise fee due to Illinois' law, which had no time limit to reach the threshold required $500 franchise fee element.

Even though eliminating the fee element seems to be straightforward, there are still a number of issues that arise that are reflected in the reported cases each year. The fee element under the FTC Rule requires: (1) as a condition of obtaining or commencing operation, (2) the payment of, or commitment to pay, $500 or more (3) before the business opens or during the first six months, (4) to the franchisor or an affiliate, (5) which is contractually required or required by practical necessity. The FTC Rule views fees broadly, unlike some states, as discussed below. Attention must be paid not only to the traditional initial payment and ongoing royalties, but payments for anything, which are sometimes referred to as indirect fees. These can include rent, advertising contributions, training, equipment, software, and copies of manuals. As long as the payment is to the franchisor or an affiliate, and the product or service must be purchased from them (versus purchasing an optional item or service), it may be considered a fee, except there is an exception for payments for the purchase of reasonable amounts of inventory at bona fide wholesale prices for resale or lease, which is important in the product franchise or traditional distributorship. The inventory exception only applies to items for resale (or leasing) and not items for use by the licensee. Issues arise over the five elements of the fee definition above and whether the licensor or its affiliate is extracting a fee by charging too high a price or imposing unreasonable minimum purchase requirements for any inventory purchased.

A fee is required under the state disclosure and registration laws, except in Oregon. Most of the state disclosure and registration laws require a fee, but do not require any minimum amount. States that do set a minimum, as does the FTC Rule, set the threshold low, between $100 and $1,000. A number of states, including Arkansas, Connecticut, Missouri, New Jersey, and Wisconsin, do not require a fee element in their definition of a franchise for purposes of their relationship laws, which means that the focus has to be on eliminating either the trademark element or control element to avoid application of the relationship law.

Issues concerning hidden fees often arise under state laws. A number of states, including California, Illinois, Minnesota, Washington, and Wisconsin, describe the fee element as a fee for the right to enter into a business or continue in business, and distinguish fees that are ordinary business expenses, which are not considered when determining if the fee element to establish a franchise exists. The issue of whether a fee is a franchise fee or an ordinary business expense often is litigated in these states. For example, a rental car agent for Avis claimed a fleet surcharge fee of 20 cents a day and a refueling fee of 35 percent of the refueling revenue were franchise fees under the California Franchise Relations Act. The court held that they were ordinary business expenses.[12] An interesting feature of the business arrangement in this case is that Avis paid the agent a commission and deducted these fees. This raises the question of whether Avis could have claimed that the two charges were not "fees" at all but merely reductions in the commission formula.

Qualify for an Exemption

There are a number of exemptions under the FTC Rule and under state law. The state law exemptions generally are under the disclosure and registration laws, not the relationship laws. The exemptions under the FTC Rule are exemptions from having to provide the disclosure document; there is no registration requirement under the FTC Rule. The exemptions under state law may be exemptions from registration but not exemptions from having to provide disclosure. In the cases where there is an exemption from providing disclosure, comparison against the FTC Rule and other state laws is necessary because the exemptions are not uniform. A licensor could be subject to one law but not the other.

The FTC Rule and a number of states have a fractional franchise rule, which provides a safe harbor and ability to quantify the lack of substantial association with the trademark and lack of significant control or assistance. Under the FTC Rule, the relationship may be exempt if the current directors or officers of the franchisor have more than two years' of experience in the same type of business and the parties reasonably believe sales from the relationship will not exceed 20 percent of the franchisee's total sales in the first year. The same type of business means a business expected to sell the same type of goods or competitive goods. The incremental sales from the relationship can be measured against sales at all of the franchisee's units, even if the product offered under the relationship is offered at only one.

The FTC Rule and some state disclosure and registration laws provide exemptions based on the sophistication of the franchisee or size of the investment. If a single individual will make an initial investment of at least $1 million, the transaction may be exempt under the FTC Rule. The FTC Rule also has a large franchisee exemption, if the franchisee (or parent or affiliate) has been in business at least five years and has a net worth of at least $5 million, and an exemption for insiders who have had management responsibility for the offer and sale of the franchisor's franchises. Some state laws also have exemptions for the large and experienced franchisor, but the exemption only applies to registration and not disclosure.

There also is a single license exclusion from the FTC Rule. The exclusion was expressed under the original FTC Rule, but it continues under the amended FTC Rule. To the extent a license must lack the degree of control to constitute a franchise the exclusion does not add anything except clarification.[13]

Conclusion

The issue whether a license will be treated as a franchise under the franchise disclosure and registration laws or the franchise relationship laws is an important one with serious consequences. There often is no easy answer to the question because of the overlapping, inconsistent, and complex laws. A knowing, informed decision should be made after analysis of the business structure.

1. The states that require disclosure are California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Washington, Wisconsin, and Virginia. All except Oregon also require either registration of the franchise offering or some filing with the state.
2. Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, 16 C.F.R. pt. 436 (2008). The FTC recently revised the FTC Rule in 2007 after a twelve year review. The amended FTC Rule is found in the Federal Register, Vol. 72, No. 61 at pages 15444-63 (March 30, 2007) and is available at *http://www.ftc.gov/bcp/menus/resources/guidance/franchise.shtm*.
3. Girl Scouts of Manitou Council, Inc. v. Girl Scouts of the United States of America, Inc., et al., 549 F.3d 1079, 2008 U.S. App. LEXIS 25844 (7th Cir. 2008).
4. Chartschlaa v. Nationwide Mutual Insurance Company, 538 F.3d 116 (2d Cir. 2008).
5. *See* Vice v. State Farm Mutual Automobile Insurance Co., Bus. Franchise Guide (CCH) ¶ 13,897 (Cal. Sup. Ct., San Joaquin County April 14, 2008).
6. To-Am Equipment Co., Inc. v. Mitsubishi Caterpillar Forklift America, Inc., 152 F.3d 658 (7th Cir. 1998).
7. The only caveat is that in New York, where many franchises do involve a trademark license anyway, under the statutory definition of franchise, either a trademark license or a marketing plan, not both, together with a franchise fee, is needed to establish a franchise.
8. *See* Gabana Gulf Distribution, Ltd. v. Gap International Sales, Inc., 2008 U.S. Dist. LEXIS 1658 (N.D. Cal. Jan. 9, 2008) and Southern States Cooperative, Inc. v. Global AG Associates, Inc., 2008 U.S. Dist. LEXIS 25858, Bus. Franchise Guide (CCH) ¶ 13,878 (E.D. Pa. Mar. 28, 2008); Franchise Rule Compliance Guide, at 3 (May 2008) available at *http://www.ftc.gov/bcp/menus/resources/guidance/franchise.shtm*.
9. Staff Report on the Proposed Revised FTC Franchise Rule at pp. 39-40 (August 25, 2004) available at *http://www.ftc.gov/os/2004/08/0408franchiserulerpt.pdf*.
10. Franchise Rule Compliance Guide, at 3–4.
11. *Id*. at 4–5.
12. Adees Corporation v. Avis Rent A Car System, 157 Fed. Appx. 2, 2005 WL 2250745 (9th Cir. 2005).
13. Staff Advisory Opinion 00-3 (Mar. 2000) (reprinted at Bus. Franchise Guide (CCH) ¶ 6507); Staff Advisory Opinion 02-1 (Jan. 2002) (reprinted at Bus. Franchise Guide (CCH) ¶ 6512; Staff Advisory Opinion 05-1 (Jan. 2005) (Bus. Franchise Guide (CCH) ¶ 6525).

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