THE INADVERTENT FRANCHISE:

When is a Dealership or Distributorship a "Franchise"?

By Leonard D. Vines

"Legal terms often have specialized meanings that can surprise even a sophisticated party. The term 'franchise,' or its derivative 'franchisee', is one of those words."[1]

I. INTRODUCTION

Manufacturers and suppliers are all too often surprised and dismayed to learn that their distributorship relationships are subject to franchise laws. A striking example is a 1999 case in which a jury awarded $1.525 million to a terminated Mitsubishi forklift distributor due to a violation of the Illinois franchise law. In affirming, the Court of Appeals for the Seventh Circuit poignantly noted:

> Like many manufacturers, MCFA (Mitsubishi) simply did not appreciate how vigorously Illinois law protects 'franchisees.' . . . While we understand MCFA's concern that dealerships in Illinois are too easily categorized as statutory franchisees, that is a concern appropriately raised to either the Illinois legislature or Illinois Attorney General, not to this court. [2]

Likewise, attorneys representing manufacturers and suppliers, as well as those representing a terminated or disgruntled distributor, do their clients a grave disservice if they fail to recognize the applicability of the franchise or related laws.[3] For example, in *Beverly Hills Concepts, Inc. v. Schatz & Schatz, Ribicoff & Kotkin*[4], attorneys representing a marketer of health and fitness business opportunities were sued for malpractice for failing to advise a client that it was subject to the Connecticut Business Opportunity Law. In *Pyramid Controls Inc. v. Siemens Industrial Automation, Inc.*[5], an attorney missed the statute of limitations for a terminated dealer because the attorney failed to recognize that the relationship was protected under the Illinois franchise law. In that case, the Seventh Circuit rejected plaintiff's argument that "only the plaintiff's actual knowledge can trigger the statute of limitations because the Franchise Act is so complicated and obscure very few attorneys understand how it works or even know of its existence."[6]

Indeed, even sophisticated lawyers and clients often fail to comprehend the breadth and scope of the franchise laws. Many fail to understand that the franchise laws, along with related laws, govern business relationships which may be vastly different from what is typically thought of as a franchise.[7]

II. WHAT IS A FRANCHISE?

Unfortunately, there is no universal definition of what constitutes a franchise. Definitions and interpretations under both federal and state law may be applicable, depending on the situation.

A. Federal Law

The Federal Trade Commission, in a promulgation known as the "FTC Rule"[8], which was recently amended, defines a franchise as a "continuing commercial relationship" which contains all of the following three elements:

1. Trademark: The franchisee is allowed to offer, sell or distribute goods, commodities, or services which are identified by a trademark, service mark, trade name, advertising or other commercial symbol;

2. Significant control or assistance: The franchisor exerts significant control or assistance over the franchisee's method of operation; and

3. Fee or Payment: The franchisee is required to pay a fee to the franchisor or its affiliates of $500 or more (other than for bona fide wholesale prices for inventory) at any time before or within six months after commencing operations of the business.[9]

If any of these three elements is missing, the business relationship is not considered a "franchise" for purposes of the FTC Rule.

B. State Laws

Although definitions employed by the states often resemble those set forth in the FTC Rule, the state definitions most often, but not always, involve a trademark element, a marketing element (rather than the "control and assistance element") and a fee element. The state laws may be narrower or broader than the FTC Rule and often extend to forms of business relationships which embrace a wide variety of dealerships, distributorships, and licensing arrangements. Under most state laws, the essential statutory definition for a "franchise" falls within one of two categories:

1. Marketing Plan: The franchisor grants the franchisee the right to engage in the business of offering, selling, or distributing goods or services under a "marketing plan or system" prescribed in substantial part by the franchisor; the business operated is substantially associated with the franchisor's trademarks, trade name, or commercial symbols; and the franchisee must pay a direct or indirect fee. The "marketing plan" element is often satisfied if the franchisor provides the franchisee with advice regarding business operations and sales of the franchisor's product or service. However, the prescribed marketing plan need not be mandatory. Rather, the element can often be satisfied

by the mere right of the franchisee to use the marketing plan recommended or provided by the franchisor.[10] Further, the content required to sufficiently establish a prescribed marketing plan is not clearly defined. Under some state's franchise laws, a franchisor's ability to control retail prices may alone suffice.[11]

2. Community of Interest: The franchisor grants the franchisee the right to engage in the business of offering or distributing goods or services using the franchisor's trade name or marks; the parties share a "community of interest" in the marketing of the goods or services; and the franchisee pays a fee. The "community of interest" element is often satisfied when there is a continuing financial interest between the parties in the operation of the franchisee's business or the sale of the franchisor's products. [12] This continuing financial interest may be manifested in the franchisee's dependence on the sale of the franchisor's products, the franchise-specific goodwill created by the franchisee, or merely the franchisee's acquired knowledge of the franchisor's products.[13]

III. LAWS GOVERNING FRANCHISES

A. Statutory Regulations

If the statutory definitional elements of a "franchise" are satisfied, the name attached to the relationship by the parties is irrelevant. The protections afforded by the franchise laws generally cannot be waived, and the benefits of the applicable statute will control, despite contractual language to the contrary. Once a business relationship falls within the statutory definition of a franchise, a variety of laws and regulations can come into play. Not all laws apply to each situation. For example, a relationship may be subject to state laws governing termination, even if it is not subject to federal disclosure requirements. However, a relationship which is a franchise under the FTC Rule will most likely also be subject to a state's relationship laws. While a number of these franchise or related laws have their own particular nuances, they generally cover the following areas:

1. Franchise pre-sale disclosure requirements and registration

If a relationship meets the definition of a "franchise" under the FTC Rule, the franchisor is required to provide a comprehensive pre-sale document[14] to a prospective purchaser. The disclosure requirement applies in all fifty states. While the FTC Rule contains no pre-sale registration requirement, the following states require the franchisor to register with a state agency before a franchise can be offered for sale: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, Wisconsin.

In addition, the following states – while not technically considered franchise registration states – also require a filing with a state agency in order to obtain an exemption under the state's business opportunity law: Connecticut, Florida, Kentucky, Nebraska, North Carolina, Texas, Utah.

2. Special Industry Laws

A wide variety of special industries are subject to specific state statutes that govern the relationship between the manufacturer or supplier and the distributor or dealer. These laws offer varying degrees of statutory protection. Common types of distribution arrangements subject to special protections include: liquor, motor vehicle, farm equipment, petroleum, and outdoor power equipment dealerships.

3. Relationship Laws

If a business relationship meets the definition of a franchise under a particular state law, some of the substantive aspects of the business relationship (i.e., termination, transfer, cancellation, and non-renewal) will be governed by that state's law. The FTC Rule does not regulate the relationship between the franchisor and franchisee after the franchise is purchased. State laws, however, are frequently designed to protect franchisees from being terminated without "good cause", from being terminated or not renewed without providing advance notice, and, to varying degrees, from being treated unfairly. Since state laws vary widely, it is particularly important to examine the applicable statute and to determine if the arrangement might be considered a "franchise". Those states which have enacted relationship laws are Alaska, Arkansas, California, Connecticut, Delaware, Hawaii, Idaho, Illinois, Indiana, Iowa, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin.

C. Exemptions and Exclusions

The FTC Rule, as well as many state franchise laws, contain several exclusions and exemptions; however, the exclusions and exemptions are by no means uniform. Among those relationships exempt from coverage under the FTC Rule are the "fractional franchise"[15], employer-employee relationships, general partnerships, leased departments, and sales to certain sophisticated investors. State exemptions vary widely. An exemption available under the FTC Rule may not be sufficient to exempt a relationship from coverage under a state law; however, some states have exemptions that are not available under the FTC Rule. In those states that require registration of the franchise, an exemption may only apply to registration, but not disclosure. It is important to note that even if an arrangement is not considered a franchise under state law, it could remain subject to the disclosure requirements of the federal law if it satisfies the three definitional elements under the FTC Rule.

IV. BUSINESS OPPORTUNITY LAWS

Despite diligent efforts to structure a relationship in a way to avoid the necessity of compliance with the franchise laws, another potential trap awaits – federal and state business opportunity laws. Although the Amended FTC Rule, effective July 1, 2008, no longer covers the sale of business opportunity ventures, disclosure requirements and prohibitions pertaining to business opportunities are now set forth in a separate Rule.[16] At the present time, this law is substantively identical to the disclosure requirements and prohibitions set forth in the original Franchise Rule. However, the FTC is contemplating amending the rule, and there is ongoing rulemaking on that issue. A business opportunity venture under the federal law contains the following three elements: (1) the buyer sells goods and services which are supplied by the business opportunity seller or a person affiliated with the business opportunity seller; (2) the business opportunity seller assists buyers in any way with respect to securing accounts for the buyer, or securing locations or sites for vending machines or rack displays, or providing the services of a person able to do either; and (3) the buyer is required to make a payment of $500 or more to the business opportunity seller (or a person affiliated with the business opportunity seller) at any time before to within six (6) months after commencing business.

The current definition is quite limited, so as a result, it is not difficult to structure a business relation in a manner in order to avoid the disclosure requirements under federal law. However, if the definitional elements of a business opportunity are met, the seller must provide the purchaser with a written disclosure document that is similar to the Franchise Disclosure Document.

In addition to compliance with the federal law, businesses and lawyers must also remain cognizant of state business opportunity laws. The following states have enacted business opportunity laws: Alaska, California, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Michigan, Minnesota, Nebraska, New Hampshire, North Carolina, Ohio, Oklahoma, South Carolina, South Dakota, Texas, Utah, Virginia, Washington, Wisconsin. Many state laws include the same types of businesses that would be subject to the federal law, including sellers of vending machines, racks, display cases, and currency-operated amusement machines, sellers that provide locations or location assistance, and sellers that agree to repurchase items that the buyer produces, grows, fabricates or assembles. However, other state business opportunity laws provide a more expansive definition which cover situations when certain representations are made, or when the seller provides the buyer with a marketing plan.

Although the state definitions of a business opportunity are not uniform, most of the state definitions deal with offers made by sellers of the business opportunity to purchasers, verbally or in writing, under which the seller will provide or sell products, equipment, supplies or services that will enable the purchaser to start the business. There is usually a minimum amount that the purchaser must pay the seller for the business opportunity. In addition, there is a requirement that the seller makes certain types of representations such as the purchaser will earn more money than the cost of the business opportunity, the seller will repurchase any goods that the purchaser does not want or that the seller will provide some type of marketing plan.

Just as the definition of business opportunity varies, the requirements associated with state business opportunity laws also vary among the several states. Most states require registration with a state agency and a written disclosure of certain types of information prior to the sale. Some states require the seller to post a bond or hold initial fees in escrow, and a few states require the seller to have a minimum net worth. Remedies for a violation of a business opportunity law vary; however, most jurisdictions provide for criminal penalties, and in some cases, the purchaser can rescind the contract and sue for injunctive relief, damages, and attorneys' fees.

Because of the complexity and lack of uniformity of business opportunity laws, it may be advantageous to structure a relationship as a franchise, because compliance may actually be less onerous. Most state business opportunity laws have certain exemptions for programs that are structured as a franchise or that the marketing plan is associated with a federally registered trademark (or in some cases a state registered trademark). However, franchisors must pay close attention to whether these states require the franchisor to file for an exemption in order to evade application of the business opportunity laws.

IV. EXAMPLES OF "HIDDEN" FRANCHISES

The wide array of cases and administrative opinions interpreting whether or not the statutory definition of a franchise is present demonstrates that there are many relationships that could unwittingly fall into the franchise trap. They have been variously referred to as "hidden", "inadvertent", or "unintended" franchises. The following cases provide just a few examples of the wide grasp of the franchise laws and their applicability to distributorship and other similar arrangements. To the untrained eye, many of these situations do not appear to involve a franchise, and, of course, these might not be considered franchises in many states.

A. Air Conditioner Dealer

In *Heating & Air Specialists v. Lennox Industries, Inc.*[17], the Court of Appeals for the Eighth Circuit held the Arkansas Franchise Practices Act applied to an air conditioner dealer, and that the Act explicitly prohibits a franchisor from canceling a franchise without good cause. The provision contained in the dealership agreements that permitted either of the parties to terminate their relationship "without cause" was found to be invalid under the Arkansas Franchise Law. Nevertheless, the court found that Lennox had good cause to cancel the franchise.

B. Appliance Dealer

The New Jersey franchise statute was applied to an exclusive distributor of appliances manufactured by Amana in *Cooper Distrib. Co., Inc. v. Amana Refrigeration, Inc.*[18] In this case, the distributor was terminated without good cause in violation of the New Jersey Franchise Law. The Court of Appeals for the Third Circuit ruled that the distributorship relationship was considered a franchise because there was a "community of interest" (distributor's assets were "substantially franchise-specific"), a license to use the trademark (use of trade names on signs, uniforms, authorized dealer and perception that the distributor was licensed) and the establishment of a place of business with the State of New Jersey (the showroom was located within the state, although no sales were consummated there).

C. Automobile Parts Dealer

A New Jersey district court, in *Beilowitz v. General Motors Corp.*[19], labeled an automobile parts manufacturer a franchise under the New Jersey Franchise Law. The court found General Motors gave its distributor the right to use its name and signage, satisfying the license requirement. Further, the distributor's investment in GM's inventory and computer systems, buttressed by his personal investment in related knowledge and skills, enabled the court to find a community of interest existed.

D. Basketball Team

The Indiana Supreme Court, in *Continental Basketball Ass'n v. Ellenstein Enterprises, Inc.*[20], found that a contract to purchase a professional basketball team was a franchise under Indiana law. The definition of a franchise was met because there was a payment for the right to operate a business, the business was substantially associated with a service mark or trademark and advertising, and the business was to be operated pursuant to the franchisor's requirements. The Supreme Court of Indiana also noted that the contract was called the "Franchise Purchase Offer", which strengthened the case against the franchisor.

E. Cafeteria in Office Building

In a California case, *Kim v. Servosnax, Inc.*[21], the court found that a franchise existed for a cafeteria that was located in an office building and operated under a contract between Servosnax and the owner of the building. The court, stating that the California law should be liberally construed, found the operation of the cafeteria was "substantially associated" with Servonsax's trademark, despite the fact that the cafeteria operator was expressly prohibited by its contract from using the licensor's name, logo, or commercial symbol.

F. Computer Training System

The defendant, a company which produced and marketed integrated learning systems that used computer technology to teach and monitor a student's progress, was found to be a franchise under the New Jersey Franchise Practices Act in *Instructional Sys., Inc. v. Computer-Curriculum Corp.*[22] This case illustrates the risk that computer hardware manufacturers and software vendors will be subject to the franchise laws.[23]

G. Copy Machine Distributor

When Ricoh Corporation refused to renew its national distributorship agreement with the plaintiff after the expiration of its one-year term, the plaintiff brought suit in *Wright-Moore Corp. v. Ricoh Corp*.[24]. The Seventh Circuit found that an independent distributor of copiers, related parts, and supplies was a franchisee under the Indiana Franchise Disclosure Law, because the business was "substantially associated" with the manufacturer's trademark.

H. Furniture Dealers

1. Missouri

The Missouri franchise relationship statute applied to an authorized dealer of an office furniture manufacturer in *American Business Interiors, Inc. v. Haworth, Inc.*[25] The dealer had a license to use the manufacturer's trade name, and the court found that the right to advertise as an authorized dealer satisfied the "community of interest" element of the Missouri franchise law. Missouri's franchise law requires a 90-day notice of termination, except under limited circumstances in which no notice is required.[26] Since the manufacturer failed to provide price information to the dealer between the date of the notice of termination and the effective date of the termination, the jury awarded the dealer $250,000 in punitive damages for tortious interference with contract.[27]

2. Illinois

An Illinois court found all three franchise elements present in furniture dealer's relationship with a licensed store owner. In *Bly & Sons, Inc. v. Ethan Allen Interiors*[28], Ethan Allen initially charged the store owner a two percent advertising contribution. This charge was held by the court to be an indirect franchise fee, regardless of whether or not the amount was paid annually.

I. Internet Providers

The action brought by the FTC in *Federal Trade Commission v. iMall, Inc*.[29] demonstrates that Internet providers may be subject to franchise laws. The marketer and its principals sold Internet consultant businesses to consumers through seminars, infomercials, and promotional cassettes. Two types of opportunities were sold: one involving the sale of WebPages on the marketer's Internet site and the other involving the sale of advertising space on a website within the Internet site. In response to FTC charges that the marketer failed to provide complete and accurate disclosure documents to prospective purchasers, the provider and its principals agreed to a settlement of $4 million.

J. Law Firm Branch Office

An administrative opinion issued by the state of Washington concluded that an out-of-state law firm that planned to open a branch office was a franchise, finding the existence of the requisite "community of interest".[30]

K. Lubricant Distributor

A California Court of Appeal, in *US MAC Corp. v. Amoco Oil*[31], concluded the relationship between Amoco and its distributor sufficiently met the franchise elements. Although Amoco sold its products at "distributor price minus 37 cents per gallon," the court was unable to determine whether this price exceeded wholesale price. Therefore, the discounted price constituted a potential hidden franchise fee.

L. Magazine Distributorship

A FTC Advisory Opinion concluded that Travelhost magazine distributorships met the three elements of a franchise.[32] In this situation, there was clearly the right to use the trade name, and there was a payment of a fee. However, Travelhost argued that since there was no "prescribed marketing plan" the third element of a franchise was not satisfied. The FTC ruled that Travelhost clearly provided significant and detailed control and assistance to distributors in all aspects of the distributors' method of operation (including ad sales, composition and layout, and magazine distribution), as well as comprehensive manuals which provided step-by-step training in each subject.

M. Office Products Dealer

In a decision that surprised many practitioners, a manufacturer of record-keeping systems and office products was held to be a franchisor within the meaning of the California Franchise Investment Law in *Gentis v. Safeguard Business Systems, Inc.*[33] The court rejected Safeguard's arguments that since its sales representatives were not allowed to enter into binding sales contracts with customers and hence could not effectuate sales, it was not subject to the state's definition of a "franchise" because the franchisee was not granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan. Instead, since the California Franchise Relations Act was remedial in nature, the court adopted a liberal interpretation of its legislative intent of the law and ruled that the business arrangement was a franchise under this California law.

N. Sales Representatives

Sales representative relationships, if not properly structured, can also be classified as a "franchise" under state or federal law.[34] Although most often a true sales representative relationship will not include the "required payment" or "fee" element that is critical to being classified as a franchise in most cases, if there is a fee imposed, or if the state statute does not include the "fee" element as part of its franchise definition, a sales representative could well be considered to be a franchise.[35]

An issue often encountered in determining whether a sales representative qualifies as a franchisee is whether a representative without the ability to bind the principal to the contract "sells" the principal's products or services. Although the relationship between a sales *manager* and a principal has been deemed a franchise, courts have been less willing to apply this same holding to the relationship between an individual sales representative and a principal, instead finding the sales representative merely promotes, rather than "sells", the principal's products. However, in a Connecticut case, *Charts & Charts Insurance Associates v. Nationwide Mutual Insurance Co.*[36], Charts, an insurance agent, was found to be a franchisee under the Connecticut Franchise Act and awarded $2.3 million in compensatory damages for termination without good cause. Nationwide controlled the pricing and availability of the insurance offered and allowed its agents to use its trademarks. Whether or not a marketing plan was imposed was irrelevant. Rather, Nationwide's ability to set pricing was indicative of a marketing plan. Further, Charts had the ability to both sell and bind Nationwide on insurance contracts he sold. It should, however, be noted that Connecticut is one of the few states that only requires two elements to be present in order to establish a franchise relationship – a marketing plan and trademark association – without the necessity of a fee.

In *Blankenship v. Dialist International Corp.*[37], a sales representative sold a listfinder device designed for attachment to telephones under a marketing plan prescribed by the manufacturer, used the manufacturer's trade name, and paid a fee for the right to do so. The Appellate Court of Illinois, therefore, considered the relationship a franchise under the Illinois franchise law.

O. Slot Machine Manufacturer

In *Atlantic City Coin & Slot Serv. Co., Inc. v. IGT,*[38] the district court found a slot machine manufacturer to be a franchisor under the New Jersey Franchise Practices Act because it had a community of interest with its distributor. As a result, termination of the relationship depended on a showing of good cause.

P. Snack Distributorship

The district court, in *Metro All Snax, Inc., v. All Snax, Inc.*[39], found that under the Minnesota Franchise Law, a snack distributorship constituted a franchise. The distributor had paid a fee for training and assistance in order to obtain the distributorship. The court ruled the control or assistance requirement for a "community of interest" was sufficiently fulfilled between the supplier and snack distributorship when the supplier and distributor shared fees from a common source. Even though the distributor never actually used the seller's trademarks, the fact that it had the right to do so was enough to satisfy the trademark element.

Q. Sports Information Service Provider

The New York Franchise Law, one of the broadest franchise statutes in the country, was applicable to an exclusive distributorship for beepers which transmitted sports information in *King Computer, Inc., v. Beeper Plus, Inc.*[40] This case involved a distributor which leased hand-held beepers that operated on a radio frequency which received sports information transmitted by the sports information provider. Under New York law, it was held that the definitional requirements of a franchise were met: (i) the distributor paid a fee for the right to be a distributor; (ii) the trademark was displayed on the beeper screen in connection with the sports information and this was sufficient to meet the trademark requirement; and (iii) even though the distributor received no direction on how to operate his business, the "marketing plan" was considered self-executing because the customers bought the beepers in order to obtain the sports information service the beeper received.

R. Sublease Agreement for Pet Shop

The sublessee, which purchased the sublessor's inventory, paid sublessor a percentage of gross income, and used the name which the sublessor also used for two other pet shops that it owned, was found to be a franchise under South Dakota law, in *Nielsen v. McCabe.*[41]

V. RISKS OF NON-COMPLIANCE

Failure to comply with franchise disclosure, registration or relationship laws, or the business opportunity laws, exposes the violator to substantial risks of civil and criminal liability. Although there is no private right of action for failure to comply with the FTC Rule[42], the Federal Trade Commission has enforcement powers to subject the non-complying party and its officers and directors to injunctions, cease and desist orders, rescission, civil fines, and criminal penalties. Private causes of action are, however, available under many state laws. Those who fail to register or provide required disclosures in the so-called "registration states" are subject to various civil remedies, such as damages, rescission, attorneys' fees, and in most cases, criminal liability. Furthermore, some states which do not require franchisors to register have enacted "Little FTC Acts," which provide that a violation of the FTC Rule is actionable under state law. The FTC Rule imposes liability on officers and directors if there is a violation, and most state laws extend joint and several liability to officers and directors and those participating in the violation as well.

Franchisors who fail to follow the mandates of state relationship laws, particularly those governing termination or failure to renew, are subject to injunctive relief and significant damages for wrongful termination. For example, in *Globe Distributors v. Adolph Coors Co.*,[43] a New Hampshire beer manufacturer relied on the language in the distributorship agreement, which allowed for termination for nonpayment without any demand or notice, to its peril. Its distributor was awarded double damages of over $10.2 million, plus attorney's fees, because the brewer failed to comply with the state statute requiring the brewer to give written notice of an intent to terminate and an opportunity to cure the claimed deficiency.

VI. MISSOURI FRANCHISE LAW

Missouri defines a franchise as "a written or oral arrangement for a definite or indefinite period in which one person grants to another a license to use a trade name, trademark or related characteristics and in which there is a community of interest in marketing of goods or services . . ."[44] Noticeably absent is the franchise fee requirement. Additionally, the statute fails to define "community of interest," and some cases have therefore interpreted the phrase broadly. In *C&J Delivery Inc. v. Emery Air Freight Corp.*[45], the District Court for the Eastern Division of Missouri held a community of interest existed when "either the franchisor benefits from the franchisee's marketing of the franchisor's product or service, or the franchisee benefits from the franchisor's marketing of the product or service."[46] The Court found a community of interest existed because the package delivery company depended upon the quality of service provided by its local delivery companies.

In addition to the license and community of interest, the franchisor or franchisee must also contemplate the establishment or maintenance of a place of business within the state of Missouri. The statute defines place of business as "a fixed, geographical location at which goods, products or services are displayed or demonstrated for sale," thereby allowing courts to easily satisfy the element.[47]

Missouri is not a franchise registration state and its franchise law does not require "good cause" or "opportunity to cure" prior to termination, unless the agreement so provides. However, except for those situations that permit immediate termination (criminal misconduct, fraud, abandonment, bankruptcy or insolvency of the franchisee, or the giving of a no account or insufficient funds check), the Missouri statute merely requires that the franchisor give notice ninety (90) days prior to termination or failure to renew.[48] If such notice is not given, even if the agreement permits a shorter time period, the franchisee may be awarded compensation for any damages including goodwill, cost of the suit and any equitable relief the court finds reasonable.[49]

VII. POSSIBLE ALTERNATIVES TO FRANCHISING

It is possible for a business to contain some, but not all, of the elements associated with a franchise without subjecting the business to FTC and state franchise laws. A business which desires to expand and obtain some of the benefits of franchising might consider some of the following alternatives, in addition to those specifically exempt or excluded from coverage under the franchise laws;[50] however, particular care must be exercised to insure that the arrangement does not fall within the purview of another type of law, such as a business opportunity law:

- Granting a license to make or use a product, invention, or secret process;
- Granting a trademark license to use a particular trademark in connection with the sale or use of a product or service;
- Direct distribution by the producer to the public or to retailers who sell to the public;
- Management agreements;
- Consignment operations;
- Sale of company-owned outlets;
- Agency or supply relationships;
- Independent manufacturer's representatives who sell products of one or more manufacturers;
- Sale of goods only.

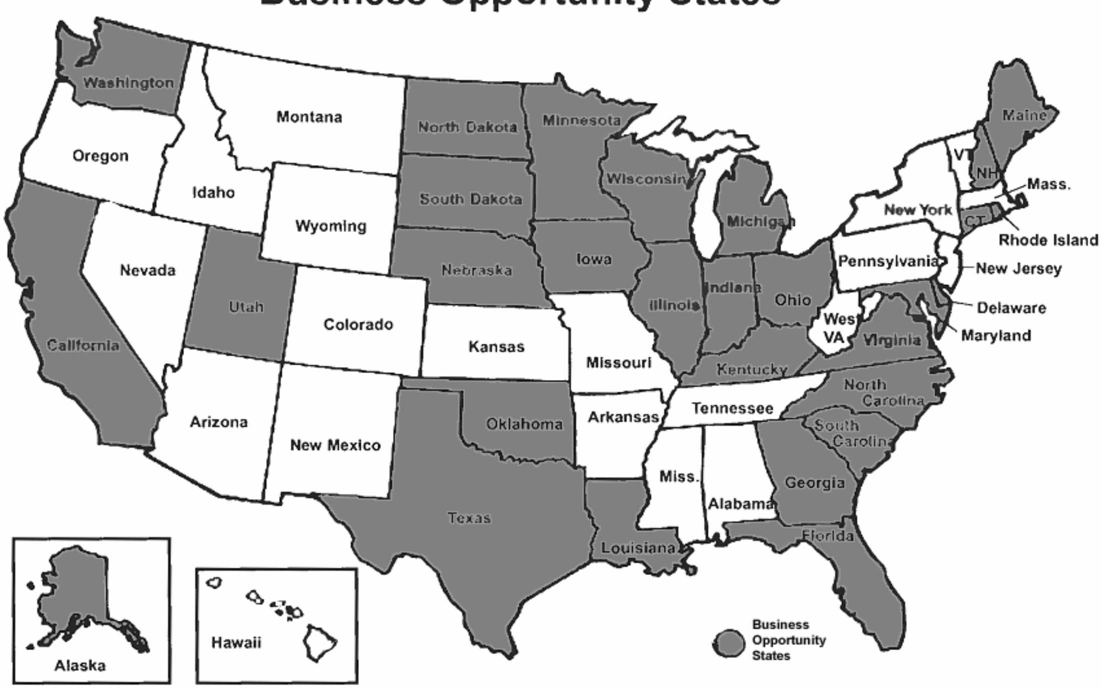
VIII. CONCLUSION

Since franchise and related laws can impact various types of business relationships in which a manufacturer or supplier produces or distributes products or services which will be sold by another, applicable federal and state laws governing the franchise relationship must be examined with great care. Manufacturers and suppliers must analyze the appropriate statutes, regulations, interpretative guides, and court decisions to determine if there is a way to structure their relationship in order to avoid the unintended or inadvertent applicability of the franchise laws. Careful drafting of contracts is essential, and possible restructuring of the relationship may be required. As attorneys become more sophisticated and aware of rulings in this field, it is likely that the franchise laws will be used more often as a weapon to challenge various aspects of unsuspecting business relationships. Those who misunderstand these laws or who fail to structure a relationship around them are subject to substantial risks and penalties, and in many cases large damage awards, not to mention the costs of defense, even if they ultimately prevail in court.

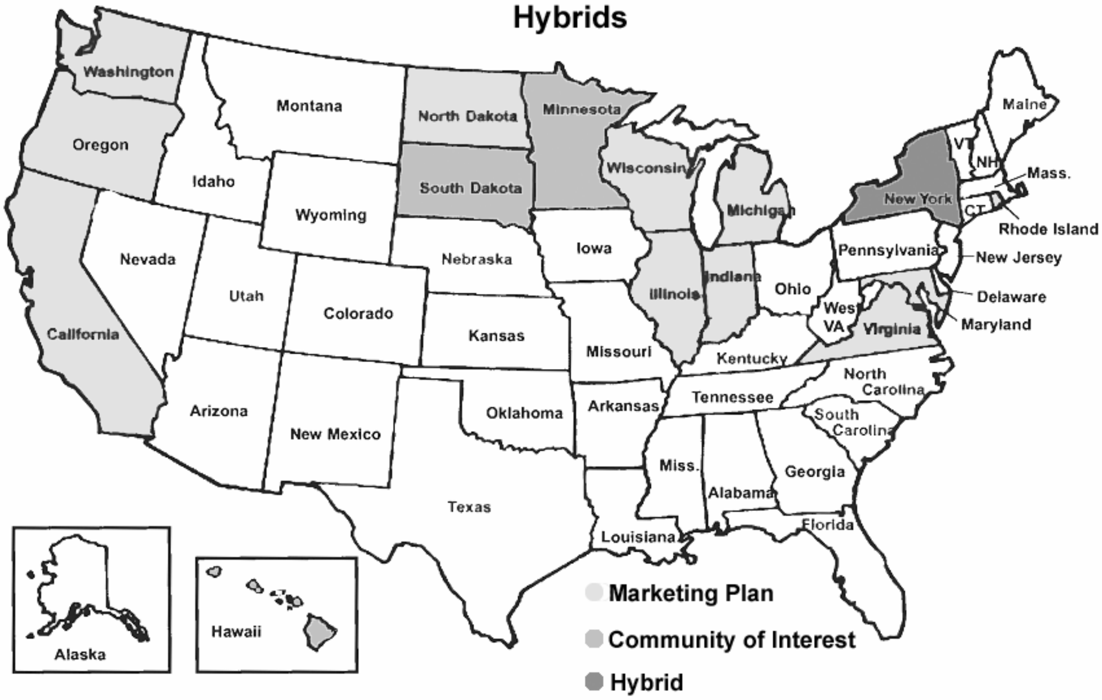
Leonard Vines is a shareholder and officer of Greensfelder, Hemker, and Gale, P.C. He gratefully acknowledges the assistance of his colleague, Marilyn Nathanson, in the preparation of this article, and Jennifer Mach, a summer associate at the firm. This paper was a adapted from and represents and expansion of an article written by the author that appeared in The Journal of the Missouri Bar, Volume 56, No. 3, May –June 2000, entitled, Dealerships and Distributorships – Beware the Franchise Minefield.

Franchise Registration and Business Opportunity States

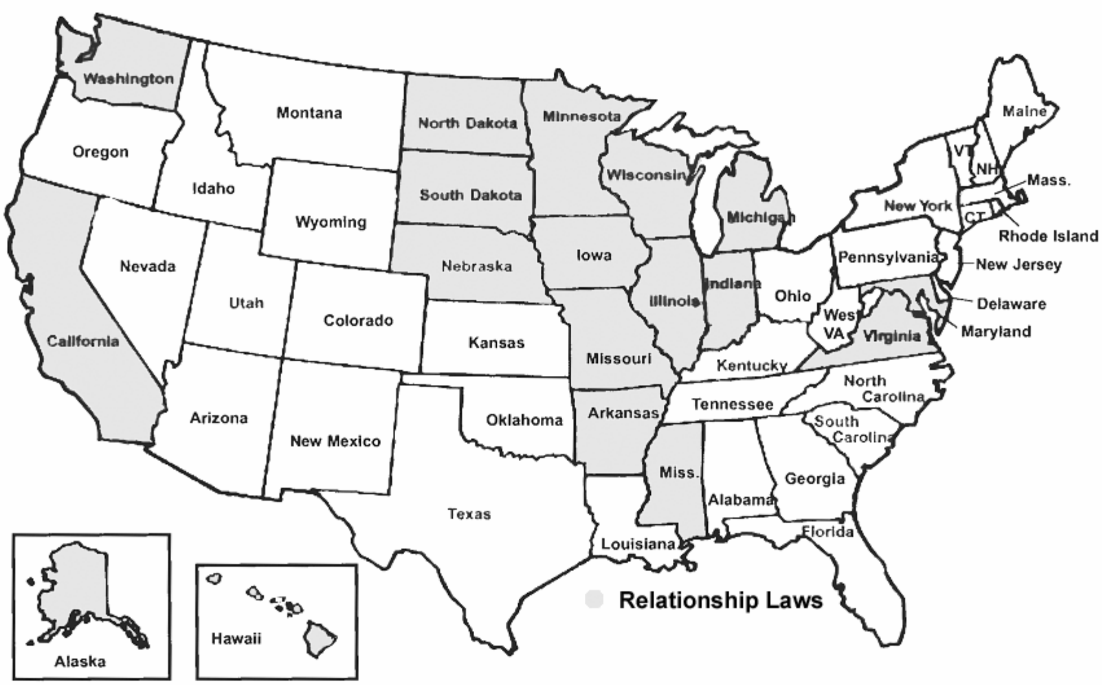
Business Opportunity States



Registration states using "Marketing Plan or System" definition
Registration states using "Community of Interest" definition
Hybrids



States with Relationship Laws



ENDNOTES:

[1] To-Am Equipment Co., Inc v. Mitsubishi Caterpillar Forklift America, Inc., 152 F.3d 658 (7th Cir. 1998).

[2] *Id.* at 666.

[3] *See* MacIntosh, Reilly, and Emerson-Henry, *The Unintended Franchise: The Collision of Modern Distribution Concepts with Mature Franchise Laws*, 1 FRANCHISE LEGAL DIGEST, Spring 1996, at 33.

[4] 247 Conn. 48 (Conn. 1998).

[5] 172 F.3d 516 (7th Cir. 1999).

[6] *Id.* at 519.

[7] James R. Sims III and Mary Beth Trice, Hidden Franchises, ABA Forum on Franchising, (Oct. 22-24, 1997).

[8] 16 C.F.R. § 436, Bus. Franchise Guide (CCH)¶ 6090.

[9] 16 C.F.R. § 436.2, Bus. Franchise Guide (CCH) ¶ ¶ 6161-6163.

[10] *See* To-Am Equipment Co., Inc. v. Mitsubishi Caterpillar Forklift America, 953 F. Supp. 987, 994, *aff'd*, 152 F.3d 658 (7th Cir. 1998) (holding that the marketing plan element is satisfied when the dealer has the *right* to sell under the marketing plan) (emphasis added).

[11] *See* RWJ Cos., Inc. v. Equilon Enterprises, LLC, No. 105CV1394 DFH/TAB, 2005 WL 3544295, at *4 (S.D. Ind. Dec. 28, 2005) (noting "price is perhaps the most fundamental aspect of a marketing plan") (citing Petereit v. S.B. Thomas, Inc., 63 F.3d 1169, 1181 (2d Cir. 1995)).

[12] Among the variations are: New York's franchise law, which requires payment of a franchise fee and either a marketing plan or substantial association with the franchisor's trademarks; Connecticut's, Missouri's and New Jersey's laws which do not require the payment of a fee; Delaware and Arkansas, which have definitions which do not fall into either category.

[13] *See* Atlantic City Coin & Slot Service Co., Inc., v. IGT, 14 F. Supp. 2d 644, 663 (D.N.J. 1998) (holding the franchisee depended on the franchisor because it derived seventy-six percent of its revenue from the franchisor's products); Lithuanian Commerce Corp., Ltd. v. Sara Lee Hosiery, 179 F.R.D. 450, 472 (D.N.J. 1998) (holding LCC invested franchise-specific goodwill, despite its simultaneous promotion of other brand's products, by focusing ninety-five percent of their promotion on the franchisor's brand); Beilowitz v. General Motors Corp., 233 F. Supp. 2d 631, 641 (D.N.J. 2002) (holding the franchisee made a significant investment in franchise-specific skills by investing his professional career in familiarizing himself with the franchisor's products, pricing, and inventory control).

[14] The offering circular has been referred to as the Uniform Franchise Offering Circular or "UFOC" for over 20 years; however, recent revisions to the Amended FTC Rule, effective July 1, 2008, refer to the disclosure document at the Franchise Disclosure Document or "FDD".

[15] A fractional franchise is created when the following two elements are present at the start of the relationship: (a) the franchisee, and the franchise's current directors or officers, or any current directors or officers of a parent or affiliate, has more than two (2) years experience in the same type of business; and (b)

the parties have a reasonable basis to anticipate that the sales arising from the relationship will not exceed 20% of the franchisee's total dollar volume in sales during the first year of operation.

[16] 16 C.F.R. § 437.

[17] 180 F.3d 923 (8th Cir. 1999).

[18] 166 F.3d 1204 (3d Cir. 1999).

[19] 233 F. Supp. 2d 631 (D.N.J. 2002).

[20] 669 N.E.2d 134 (Ind. 1996). The decision cited Thomas M. Pitegoff, *Franchise Relationship Laws: A Minefield for Franchisors*, 45 BUS. L. 289 (1989).

[21] 10 Cal. App. 4th 1346 (Cal. Ct. App. 1992).

[22] 35 F.2d 813 (3d Cir. 1994), *cert. denied*, 513 U.S. 1183 (1995). Note that the definition of a franchise under the New Jersey franchise law does not contain the "fee" element that exists in most state definitions.

[23] See also Current Technology Concepts, Inc. v. Irie Enterprises, Inc., 530 N.W.2d 539 (Minn. 1995), in which the court found that a payment of $125,000 by a software distributor for a hospital billing program constituted a franchise fee under Minnesota's franchise law. For a further discussion of franchise implications for computer hardware and software vendors, see M.J. Lockerby, *Avoiding Collisions With Franchise Laws on the Information Superhighway*, 15 THE COMPUTER LAWYER, No.10, 8-18 (October 1998).

[24] 908 F.2d 128 (7th Cir. 1990).

[25] 798 F.2d 1135 (8th Cir. 1986).

[26] MO. ANN. STAT. § 407.405 (2001).

[27] Note that punitive damages were based on tortious interference. Punitive damages are not available for violation of the Missouri Franchise Act. *See* Ridings v. Thoele, Inc., 739 S.W.2d 547, 548 (Mo. banc 1987).

[28] No. CIV. 05-668-GPM, 2006 WL 2547202, at *3 (S.D. Ill.)

[29] Bus. Franchise Guide (CCH) ¶11, 624 (C.D. Cal. 1999).

[30] State of Washington, Department of Licensing, Administrative Opinion File. No. E-12978, Feb. 7, 1989, *cited in* 9 FRAN. L.J., Fall 1989, No.2 at 3, 5. But see Matter of Wallach, Bus. Franchise Guide (CCH) ¶ 9587 (N.Y. Sup. Ct. Jan. 4, 1990), in which an airplane broker's required purchase of stock in a subsidiary of its supplier was not a franchise under the New York franchise law.

[31] Bus. Franchise Guide (CCH) ¶ 11, 963 (Cal. Ct. App. Aug. 16, 2000).

[32] FTC Advisory Opinion, Travelhost Magazine, Inc. (March 2, 1989), Bus. Franchise Guide (CCH) ¶ 6444.

[33] 60 Cal. App. 4th 1294 (Cal. Ct. App. 1998), , *reh'g denied*, 61 Cal. App. 4th 868A (1998).

[34] The interpretive guides to the FTC rule specifically provide that sales agents are not franchises in cases "in which independent agents, compensated by commission, sell goods or services (e.g. insurance salespersons) . . . since there is no 'required payment.'"

[35] *See* Baer, Beyer, and Weber, *When Are Sales Representatives Also Franchisees?*, 27 FRANCHISE L. J., 151 (Winter 2008).

[36] Bus. Franchise Guide (CCH) ¶ 12, 987 (D. Conn. 2004)

[37] 568 N.E.2d 503 (Ill. App. Ct. 1991).

[38] 14 F. Supp. 2d 644 (D.N.J. 1998).

[39] Bus. Franchise Guide (CCH) ¶ 10, 885 (D. Minn. 1996).

[40] No. 92 Civ. 5494, 1993 U.S. Dist. LEXIS 2707 (S.D.N.Y. Mar. 9, 1993).

[41] 442 N.W.2d 477 (S.D. 1989).

[42] Banek, Inc. v. Yogurt Ventures USA, Inc., 6 F.3d 357 (6th Cir. 1993).

[43] 129 B.R. 304 (Bankr. D.N.H. 1991).

[44] MO. ANN. STAT. § 407.400(1) (2001).

[45] 647 F. Supp. 867 (E.D. Mo. 1986).

[46] *Id.* at 872.

[47] MO. ANN. STAT. § 407.400(2) (2001). *See* C&J Delivery Inc. v. Emery Airfreight Corp., 647 F. Supp. 867, 873 (E.D. Mo. 1986) (holding the "place of business" element was satisfied by a package drop-off facility in Missouri owned by the franchisor).

[48] MO. ANN. STAT. § 407.405 (2001).

[49] MO. ANN. STAT. § 407.410(2) (2001).

[50] *See* Garner, Franchise & Distribution Law & Practice § 1:11, et seq.