FRANCHISING – LITIGATING THE DEFINITIONAL ELEMENTS

David Gurnick
Lewitt Hackman Shapiro Marshall & Harlan
Los Angeles, California

Jeffery S. Haff
Dady & Gardner
Minneapolis, Minnesota

Craig Miller
Gray Plant Mooty
Minneapolis, Minnesota

October 10 – 12, 2018
Nashville, Tennessee

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I. INTRODUCTION

A franchise relationship is defined by statute, regulated by both federal and state law, and its existence is determined case-by-case. A court’s inquiry focuses on whether the elements of a franchise are present, largely without consideration of the parties’ intent. Referring to the arrangement as a joint venture, dealership, license, or by some other name, will not prevent a court from declaring the relationship a franchise, subjecting it to franchise laws and regulations. Thus, it is important to understand whether a commercial arrangement meets the legal definition of a franchise in order to avoid an unintended franchise relationship, often referred to as a “surprise” or “accidental” franchise. Federal and state laws define the franchise relationship differently, making it critical to understand the governing statutes before entering into a commercial relationship.

In litigating whether a business relationship is a “franchise,” counsel must delve into the often-difficult area of how to interpret statutes and regulations defining a “franchise” and the elements of a “franchise.” The elements generally include (but do not always include): (1) a franchise fee being paid; (2) use of a trademark or association with the trademark; (3) a “community of interest” between the parties; and/or (4) some form of franchisor control or marketing plan/assistance from the franchisor to the franchisee.

We necessarily start by asking when a business relationship is a franchise. It is often said that if something “looks like a duck and walks like a duck and quacks like a duck” then it is probably a duck. But statutory definitions of franchises are not always clear, leaving much for the courts to determine. At times, a word or term used in a statute is not interpreted the same as its “everyday language” definition. For example, in Nix v. Hedden, the United States Supreme Court reviewed the Tariff Act of 1883 to determine if a tariff imposed by Congress on foreign vegetable imports applied to tomatoes. The Supreme Court held that, for purposes of the statute, Congress intended a “vegetable” to include any food item derived from a plant and generally served as a side dish to the main course at dinner, but not separately at dessert. As a

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1 Intent is not entirely irrelevant. See e.g., Jerome-Duncan, Inc. v. Auto-By-Tel, LLC, 989 F. Supp. 838, 842 (E.D. Mich. 1997), aff’d 176 F.3d 904 (6th Cir. 1999) (noting “the word ‘franchise’ does not appear anywhere in the parties’ agreement. While not dispositive, it is clearly probative of what type of agreement was reached.”). See also James v. Whirlpool Corp., 806 F. Supp. 835, 842 (E.D. Mo. 1992) (holding that an agreement “was a distributorship agreement, not a franchise agreement. Nowhere in the Agreement is the word franchise used.”).

2 See e.g., Paul Fransway, Traversing the Minefield: Recent Developments Relating to Accidental Franchises, 37 Franchise L. J. 217 (2017); Charles S. Modell, Joseph J. Fittante Jr., Avoiding the Accidental Franchise, 76 Wis. Law. 10 (May, 2003) (noting franchise and dealership laws “offer a potential trap for the unwary—the creation of an accidental franchise, with resulting severe penalties and restrictions.”); Leonard D. Vines, Dealerships and Distributorships—Beware of the Franchise Minefield, 56 J. Mo. B. 163 (2000) (“Manufacturers and suppliers are all too often surprised and dismayed to learn that their distributorship relationships are subject to the franchise laws.”).

3 Cases are legion in citing the “Duck test.” See, e.g., Zebel, LLC v. U.S., 135 Fed. Cl. 47, 64 (Fed. Cl. 2017); Broadwater Development, L.L.C. v. Nelson, 219 P.3d 492, 497 (Mont. 2009) (“if something ‘looks like a duck, walks like a duck and quacks like a duck, it must be a duck . . . . even if it is holding a piece of paper that says it is a chicken.”).

result, the Supreme Court ruled that a tomato is a vegetable for purposes of the statute, despite botanists classifying a tomato as a "fruit."\(^5\)

If a tomato “in real life” is actually a fruit but can be legislatively defined as a “vegetable,” it is no wonder that cases across the nation regarding what is and is not a “franchise” are difficult to predict and pin down.

This paper will address issues that have arisen regarding the various elements of a “franchise” and situations where courts found that a “franchise” exists, though the general public would not consider the relationship to be a “franchise,” and situations where no “franchise” was formed, even though it appears that the relationship was a franchise relationship. When litigating whether a “franchise” exists, there are many legal and factual issues to consider.

II. LITIGATING THE FRANCHISE FEE ELEMENT

A. FTC Rule Guidance

The Federal Trade Commission Franchise Rule (“FTC Rule” or “Rule”)\(^6\) states that a franchise exists when the following elements are present:

Franchise means any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:

(1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor’s trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor’s trademark;

(2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee’s method of operation, or provide significant assistance in the franchisee’s method of operation; and

(3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.\(^7\)

All three elements must be present for a franchise relationship to exist under the FTC Rule.

The term “franchise fee” is not used in the FTC Rule. The term used in the FTC Rule is “required payment,” which is defined as follows:

\(^5\) Id. See also WIKIPEDIA, https://en.wikipedia.org/wiki/Tomato (last visited June 29, 2018). As Wikipedia notes, from a botanical standpoint, “a tomato is a fruit, a berry, consisting of the ovary, together with its seeds, of a flowering plant. However, the tomato has a much lower sugar content than other edible fruits, and is therefore not as sweet. Typically served as part of a salad or main course of a meal, rather than at dessert, it is, in the US, considered a ‘culinary vegetable.’”

\(^6\) 16 C.F.R. § 436.1.

\(^7\) Id. at § 436.1(h).
**Required payment** means all consideration that the franchisee must pay to the franchisor or an affiliate, either by contract or by practical necessity, as a condition of obtaining or commencing operation of the franchise. A required payment does not include payments for the purchase of reasonable amounts of inventory at bona fide wholesale prices for resale or lease.\(^8\)

The franchisee must pay a fee of at least $570 (as currently indexed for inflation) under the FTC Rule, and must do so within 180 days of signing the franchise agreement. The FTC Rule definition is not specific or helpful to one wondering what sort of payment qualifies as a “required payment,” because the Rule seems to state that any required payment counts as a franchise fee, except “payments for the purchase of reasonable amounts of inventory at bona fide wholesale prices for resale or lease.”\(^9\)

A “required payment” need not be called a “franchise fee” or any other magic word or words to satisfy the FTC Rule. Franchisors often refer to such fees as “franchise fees,” but entities trying to avoid being found to be franchisors have called such fees “consulting fees,” “license fees,” “training fees,” “site assistance fees,” “administrative fees,” “management fees,” “partnership fees,” “joint venture fees” and other similar names. The key under the FTC Rule is whether the fee is provided in return for the right to obtain or commence operation of the business.

**B. Types of “Fees” or “Required Payments”**

Many state laws that regulate franchising have *de minimis* exemptions for fees that require payment of only insignificant amounts.\(^10\) Other state statutes regulate (or arguably regulate) aspects of franchising, yet do not require a fee to be paid at all.\(^11\)

Whether a “franchise fee” or “required payment” is charged is most often litigated in distribution disputes between a manufacturer and a distributor. Under most state franchise regulation statutes, a distributor who uses a manufacturer’s trademark or trade name will be a “franchisee” if the distributor pays a fee.\(^12\) A large number of decisions address whether a dealer/distributor paid a “franchise fee,” as defined by state law, thus making the distributor a “franchisee” in the eyes of the law. For example:

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\(^8\) Id. at § 436.1(s).

\(^9\) Id.


\(^12\) See Metro All Snax, Inc. v. All Snax, Inc., Bus. Franchise Guide (CCH) ¶ 10,885 (D. Minn. Mar. 21, 1996) (snack food and novelties distributor that paid a training fee was a franchisee under Minnesota Franchise Act). But see Rogovsky Enter., Inc. v. Masterbrand Cabinets, Inc., 88 F. Supp. 3d 1034 (D. Minn. 2015) (payment by cabinet distributor of $300,000 for improving its showroom, in which distributor also promised not to sell products competing with manufacturer, was not a franchise fee under Minnesota Franchise Act).
Chicago Male Medical Clinic, LLC v. Ultimate Management, Inc.\textsuperscript{13} (franchisee prevailed in bench trial on rescission claim for violation of the Illinois Franchise Disclosure Act. A $300,000 initial cash payment in the parties' consulting agreement met the requirement of a franchise fee).

Romeo Maintenance & Rental v. U-Haul Co. of Minnesota\textsuperscript{14} (U-Haul dealer's minimum purchase requirements and other payments required to operate the franchise may be a "franchise fee" for purposes of Minnesota Franchise Act).

BP West Coast Products, LLC v. Shalabi\textsuperscript{15} (gas station owner survived a motion to dismiss on franchise fee issue where he may have paid more than a bona fide wholesale price due to a "zone price scheme" and because of faulty deliveries and payment to operate an ampm store, since the gas station owner could not have one without the other).

In other instances, courts were not as receptive to the argument that a required payment was a franchise fee. For example, in Adees Corp. v. Avis-Rent-A-Car System, Inc.,\textsuperscript{16} the trial court found that, while statements in a franchise agreement that no franchise fee was paid were not dispositive, fleet surcharges and refueling charges were not "franchise fees." The court determined that the key analysis (using factors from other courts) was: (1) did the payor receive something of value; (2) was the payment an ordinary business expense or an unrecoverable investment; and (3) did the payor put its own money at risk.\textsuperscript{17}

From an analysis of these three factors, the court concluded that the monies Avis charged were not franchise fees. The fleet surcharge was not a franchise fee because Adees received something of value in return—a fleet of cars that was necessary to run a business. The payment was an ordinary business expense. Moreover, Adees did not put money at risk since its commissions were reduced by the surcharge. As for the refueling charge, there would be no sale of gas without the car rental, which required the use of Avis' fleet of vehicles. Because Avis provided the inventory that made the gas sale possible, its retention of a percentage of the gross revenue from the entire transaction did not convert the refueling charge into a fee for the right to do business.


\textsuperscript{16} 2003 U.S. Dist. LEXIS 26293, at *1 (C.D. Cal. Nov. 19, 2003), aff'd, 157 F. App'x 2 (9th Cir. 2005).

\textsuperscript{17} \textit{Id.}
As noted by the Adees court, the three “franchise fee” factors used in Adees have also been used in other state cases.\textsuperscript{18} This standard, however, seems to favor the payor of the fee.\textsuperscript{19}

An analysis focused on whether the putative franchisee receives “something of value” or whether the required payment is simply an “ordinary business expense” does not appear to be particularly satisfactory, especially when statutes that identify what is a franchise fee specifically state that a training fee or training school fee is a franchise fee.\textsuperscript{20} It is, therefore, no surprise that this element is inconsistently interpreted.

C. “Ordinary Business Expense”

Nearly anyone who wants to be in business needs employee and manager training and, therefore, has an “ordinary business expense” for training. Similarly, the issue of whether a payment is an “unrecoverable investment” will often be answered in the affirmative (finding the investment is unrecoverable) if the business is unsuccessful and in the negative (meaning that the investment is recoverable) if the business is successful. It is the rare franchisor who would claim in a Franchise Disclosure Document that the payment of a franchise fee for one of its franchises is an “unrecoverable investment.” The franchisee receives some value for the initial franchise fee. For example, most franchisors will concede that the “initial franchise fee” is partially a “training fee” and that is what the franchisee is paying for. The franchisee may recover some or all of the value of the initial franchise fee by operating a better trained workforce. Courts should be careful not to define the issue of whether a fee is a “franchise fee” by determining whether something of value is received for the fee. Any payment other than an outright gift is made “for” something, and is assumed by the person paying the fee to be a payment for value. Arguing that certain fees are “recoverable” while “franchise fees” are unrecoverable, really just begs the question.

A better understanding of the term “ordinary business expense” can be found, for example, in the text of the Minnesota Franchise Act. This Act states that a business expense is


\textsuperscript{19} See, e.g., Desert Buy Palm Springs, Inc. v. DirectBuy, Inc., No. EDCV1100107SVWGCX, 2011 WL 13224851, at *3 (C.D. Cal. Apr. 6, 2011) (finding that expenses incurred relating to contributions to a marketing and legislative fund, training, local advertising, and required purchases in the form of an in-store decor and marketing materials for display were not indirect franchise fees); JICO, Inc. v. Isuzu Motors Am., Inc., No. CIV. 08-00419SOMLEK, 2009 WL 1444103, at *5 (D. Haw. May 22, 2009) (finding that whether the purchase of tools, parts, service equipment, communication system licensing fees, marketing fees, signs, employee training expenses, flooring arrangements, and service pricing constitute a franchise fee is a question of fact not appropriate for summary judgment). But see Atchley v. Pepperidge Farm, Inc., No. CV-04-0452-EFS, 2012 WL 777159, at *6 (E.D. Wash. Mar. 8, 2012) (questioning whether the “ordinary business expense” for services rendered factor is exempted from Washington’s Franchise Investment Protection Act definition of a franchise fee).

\textsuperscript{20} See, e.g., MINN. STAT. § 80C.01, Subd. 9 (2018) (specifically listing “any training fees or training school fees or charges” as specifically being a franchise fee).
not a franchise fee if the payment of "fair market value" is for "supplies or fixtures" or "real property" required to operate the business. This makes more sense, given that almost any dealer or distributor would require land, building, furniture, fixtures, and equipment to operate a business, but the need for these items should not create a "franchise" from a dealership or distributorship. The test in Adees and cases it cites, however, could lead to, for example, training fees and royalties and even an up-front payment called a "franchise fee" being deemed to not be "franchise fees." All of these payments, are arguably "for something" and arguably "ordinary business expenses" that are "recoverable."

D. "Bona Fide Wholesale Price"

The issue whether a "franchise fee" exists because the franchisee does not buy product at a "bona fide wholesale price" is occasionally litigated. One example is Coyne's & Co. v. Enesco, LLC. In Coyne's the distributor argued that it could not be terminated as a distributor because its supplier failed to comply with the good cause, notice, and opportunity to cure pretermination requirements of the Minnesota Franchise Act.

The Eighth Circuit rejected the distributor's allegation that it paid a franchise fee, despite the distributor producing evidence that (1) the distribution contract had a minimum purchase requirement for inventory, and (2) the supplier's 35-50% mark-up on the products to the distributor was excessive. The Eighth Circuit stated that there was no assertion or showing by the distributor that the minimum purchase requirement was unreasonable, because the distributor never alleged that it was required to purchase amounts it would not otherwise have purchased for its business. As to the 35-50% mark-up, the Eighth Circuit borrowed from a case construing South Dakota's franchise law, which has language similar to Minnesota's, to find that the district court had found the mark-up consisted only of the supplier's profit, which still constituted a "bona fide wholesale price." The distributor failed to establish that the trial court's finding of a "bona fide wholesale price" was "clearly erroneous," which was the standard of review on appeal, and "[t]he question of whether the mark-up is a bona fide wholesale price or an indirect franchise fee is a fact-specific inquiry."

While the Coyne decision holds that "profit margins" are not "franchise fees," the Eighth Circuit's decision does not explore the issue of what exactly constitutes a "bona fide wholesale price" and never articulates any bright line test for the circumstances when a price markup could possibly cross the line into indirect franchise fees. The Coyne court found the marked-up price was a bona fide wholesale price.

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21 MINN. STAT. § 80C.01, Subd. 9(e) and 9(f). See also the following statutes listing payments not to be considered a franchise fee: CAL. CORP. CODE § 31011; HAW. REV. STAT. § 482E-2, subd. 8; 815 ILL. COMP. STAT. § 705/3, subd. 14; INDIAN CODE §§ 23-2-2.5-1, subd. 1(i); IOWA CODE § 523H.1, subd. 4; MD. CODE ANN., BUS. REG. § 14-201, subd. f; MICH. COMP. LAWS § 445.1503, § 3, subd. 1; N.Y. GEN. BUS. LAW § 681, subd. 7; N.D. CENT. CODE § 51-19-02, subd. 6; R.I. GEN. LAWS § 650.005, subd. 4; WASH. REV. CODE § 19.100.010, subd. 8; WIS. STAT. § 553.03, subd. 5(m).

22 553 F.3d 1128 (8th Cir. 2009).

23 Id.

24 Id. at 1132.
By contrast, the Ninth Circuit has found that a “franchise fee” might exist in a case where the supplier overcharged the distributor for motor oil and tires, batteries, accessories, and specialties.  

III. LITIGATING THE TRADEMARK ELEMENT

A. FTC Rule Guidance

The FTC Rule addresses the trademark element in its definition of a “franchise,” as follows:

The franchisee will obtain the right to operate a business that is identified or associated with the franchisor’s trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor’s trademark;

The definition leaves some doubt as to how much the “business” needs to be “identified or associated” with the trademark. In addition, the definition goes on to state that the franchisee does not need to have its whole business associated with the trademark if the franchisee offers, sells or distributes the franchisor’s goods or services (or commodities) that are associated with the franchisor’s trademark. Therefore, possibly all that is required to satisfy this element of the FTC Rule definition is for the distributor to accept for sale products of the franchisor that are associated with the franchisor’s trademark.

The FTC makes up for this lax standard for its “trademark” element by also requiring that:

(2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee’s method of operation, or provide significant assistance in the franchisee’s method of operation; and...

B. Necessary Connection to the Franchisor’s Trademark

Against this background, states that regulate franchising have taken different paths toward how much “trademark” usage/association is required to be a franchisee. For example, Minnesota requires only the “right” to use the franchisor’s trademark. Other states require a grant of a license to use the franchisor’s trademark. By contrast, Wisconsin courts interpreting the Wisconsin Fair Dealership Law have plumbed the depths of the term “community of interest” so much that this term has bled over into an analysis of how much the dealer is actually associated in the public’s eye with the franchisor’s trademark.

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25 See Blanton v. Mobil Oil Corp., 721 F.2d 1207, 1220 (9th Cir. 1983) (stating that under Washington’s Franchise Investment Protection Act, the term “franchise fee” includes “fees hidden in the franchisor’s charges for goods or services.”). See also Atchley v. Pepperidge Farm Inc., 379 F. App’x 557 (9th Cir. 2010).

26 Minn. Stat. § 80C.01, subd. 4(1)(i.); Metro All Snax, supra note 12, at 3 (distributor had contractual right to use the trademark, the fact that it failed to do so was irrelevant).


One common statutory element of the “franchise” definition (used by 15 states) is that the franchisee’s business must be “substantially associated” with the franchisor’s trade name or trademark.\(^2^9\) Cases addressing this “substantially associated” prong include the following:

- \textit{Kim v. Servosnax, Inc.}\(^3^0\) (finding that licensee’s business operating an office building cafeteria was “substantially associated” with symbols of the licensor so as to qualify as a “franchise” under California Franchise Investment Law even though the licensee was prohibited from using the licensor’s name in relation to customers; the trademark element was satisfied because the name had been used in obtaining the agreement with the property owner to place the cafeteria in its office building).

- \textit{Carlos v. Philips Business Systems, Inc.}\(^3^1\) (finding that a distributor demonstrated that its franchise was “substantially associated with” the franchisor’s trademark, and therefore fell within the coverage of the Connecticut Franchise Act, where the distributor was encouraged to associate the business with a manufacturer’s trademark, made extensive use of the trademark, the business telephone was answered by using the trademark name, and the business station prominently featured the franchisor’s name, among other things).

As stated above, some states tighten their definition of “franchise” by increasing the level of association that is required with the franchisor’s trademark.\(^3^2\) But, as noted above regarding the FTC Rule and Wisconsin Fair Dealership Law, some courts focus less on the issue of being “substantially associated” and more on a statutory requirement that a “community of interest” or “marketing plan” exist as a way to assess claims that a dealer, distributor or licensee is really a “franchisee,” even if the dealer pays a franchise fee and uses the franchisor’s trademark.

\section*{IV. LIETING THE SUBSTANTIAL CONTROL ELEMENT}

The substantial control element is approached and analyzed in three different ways—applying the FTC Rule interpretation, requiring the existence of a marketing plan, or identifying a community of interest. The FTC Rule provides guidance for what conduct constitutes substantial control. However, some states approach the element by looking for the presence of a marketing plan, while other states focus on a community of interest.


\(^{3^2}\) \textit{See footnotes 24–27 supra.}
A. FTC Rule

As discussed above, the FTC recognizes a commercial relationship or arrangement as a franchise when three elements are present: (1) the right to associate with a trademark; (2) a significant degree of control or assistance over the method of operation; and (3) payment of a required fee. This section focuses on the second element—significant degree of control over the method of operation.

Significant control is typically satisfied when the franchisor exerts or has authority to exert a large degree of control over the franchisee’s method of operation, or provides significant assistance in the franchisee’s method of operation. Conduct establishing significant control typically includes formal training programs, providing marketing advice or marketing plans, and offering shared programs, databases or websites. The FTC has stated that promotional activities alone will not be deemed significant control or assistance.

B. FTC Rule Interpretation

A majority of states rely on the federal definition for guidance when analyzing a relationship or contract. The FTC Rule does not reference a marketing plan, but instead is concerned with the potential franchisor’s degree of control over the potential franchisee’s operations. The FTC Rule does not include a definition of “significant control,” but the FTC’s Compliance Guide explains that the term relates to “the degree to which the franchisee is dependent upon the franchisor’s superior business expertise – an expertise made available to the franchisee by virtue of its association with the franchisor.” In Federal Trade Comm’n v. International Computer Concepts, Inc., an Ohio federal court quotes this sentiment and explains that a franchisor shares its expertise by exerting control over the franchisee’s operations and in return, franchisees have lower risk of making mistakes.

C. Examples of Conduct that Does or Does Not Constitute Substantial Control Under the FTC

The Compliance Guide provides a number of examples of significant control, including:

(1) site approval for unestablished business;

33 16 C.F.R. § 436.1.


35 The Compliance Guide was drafted by the Federal Trade Commission in 2008 to help franchisors understand the FTC Rule. It serves as an explanatory resource, and does not amend or alter the language of the FTC Rule. The Compliance Guide is available online at www.ftc.gov/system/files/documents/plain-language/bus70-franchise-rule-compliance-guide.pdf.


(2) site design or appearance requirements;
(3) hours of operation;
(4) production techniques;
(5) accounting practices;
(6) personnel policies;
(7) promotional campaigns requiring franchisee participation or financial contribution;
(8) restrictions on customers; and
(9) locale or area of operation.38

In Mercy Health Sys. of Southeastern Pennsylvania v. Metro. Partners Realty LLC,39 a Pennsylvania court analyzed the above factors and concluded a franchise relationship did not exist between a hospital and its landlord. The hospital argued the landlord’s control over food vendors, hours of operation, and “signage” as detailed in the lease agreement was sufficient to establish sufficient control.40 However, the landlord had no control over physician hiring, hospital advertising, the hospital’s community activities, or medical equipment used.41 Thus, the sufficient control element was not satisfied.

Specific examples of significant assistance include: (1) formal sales, repair, or business training programs; (2) establishing accounting systems; (3) furnishing management, marketing, or personnel advice; (4) selecting site locations; (5) furnishing systemwide networks and a website; and (6) furnishing a detailed operating manual.42 In FTC v. Sage Seminars, Inc.,43 a California federal court analyzed “significant assistance” under the FTC Rule. The court noted that the only evidence presented to establish “significant assistance” was the alleged franchisor’s assistance with promotional activities. The court determined assisting with promotional activities alone was insufficient to rise to the level of “significant assistance” under the FTC Rule.

In Safe Step Walk in Tub Co. v. CKH Industries, Inc.,44 a New York federal court analyzed a commercial relationship under the FTC Rule. The parties, a trademark holder and

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40 Id. at 4.
41 Id.
42 FTC Rule Compliance Guide, p. 3.
44 242 F. Supp. 3d at 245.
licensee, provided in the license agreement that the arrangement was not to be considered a franchise. The court, however, determined a franchise relationship was likely present because the trademark holder had sufficient control over the licensee through mandatory training, required financial reporting, and prohibiting the sale of competitors' products. This demonstrates the necessity of understanding how courts interpret the FTC Rule and structuring commercial arrangements accordingly.

The following activities would likely be individually insufficient to establish a franchise relationship under the FTC Rule: (1) promotional activities intended to help the distributor make sales; (2) imposition of health or safety restrictions required by law; (3) aiding distributors in obtaining financing to be able to conduct business; or (4) trademark controls designed solely to protect the trademark owner's legal ownership rights to the mark.  

The FTC will not consider promotional activities alone as amounting to significant control or assistance, and a federal court added clarification to that standard in *FTC v. Communidyne, Inc.* 46 In *Communidyne*, the FTC alleged that a breathalyzer manufacturer was a franchisor because it distributed letters and brochures offering training and marketing suggestions. The Illinois federal court determined the materials were only promotional offers rather than promises, and did not rise to the "significant assistance" standard. The court clarified that even if the promotional offers were considered promises, their content did not qualify as "significant assistance."

In *Englert, Inc. v. LeafGuard USA, Inc.*, 47 the court held that a license agreement did not create a franchise relationship. The South Carolina federal court focused on the licensor's ability to control only one of the licensee's product lines. The licensee argued that the licensor limited the selling territory and required sales and accounting reports, but the court determined the conduct did not amount to significant control under the FTC Rule. 48 In rationalizing this decision, the court noted that in order to be rendered "significant" under the FTC, "the controls or assistance must be related to the franchisee's entire method of operation—not its method of selling a specific product or products which represent a small part of the franchisee's business." 49

Every trademark owner must protect its mark. However, it is not conceptually difficult for a party on either side of a dispute to argue that any element of control is for the purpose of trademark protection, since potentially every aspect of the operation of a licensed or franchised business may potentially impact the goodwill and reputation of the brand. In contrast, it is not

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45 The FTC has stated as a matter of Commission policy that these activities will not alone establish sufficient control. FTC, Franchise Rule Compliance Guide, at p. 2–4 (citing Original Interpretive Guides, 44 Fed. Reg. 49,966, at 49,967 (Aug. 24, 1979)).


48 Id. at *4.

49 Id. at *3.
difficult to make the contrary argument that particular control elements go beyond what is necessary to protect the trademark.  

D. State Marketing Plan Statutes

Twenty-two states\(^{51}\) have laws that differ from the FTC “franchise” definition. The difference lies in the second element, where states replace the FTC’s “significant control or assistance” requirement with a more specific requirement. Fourteen of these states\(^{52}\) replace the control requirement with the existence of a prescribed marketing plan, while the remaining eight\(^{53}\) replace the control element with a community of interest requirement. All states, whether applying the FTC Rule or a state franchise statute, retain the trademark and franchise fee elements, except New York. Some state statutes clearly delineate what activities constitute a marketing plan, while other states rely on case law to interpret the marketing plan element.

E. “Marketing Plan” Definitions by States

In states that define “franchise,” the most widely used language regarding the element of “marketing plan” is “an oral or written agreement in which a franchisee is granted 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 a franchisor.”\(^{54}\) New York has one of the broadest franchise statutes. Under New York law, a franchise relationship exists if just two elements are present: (1) the existence of either a marketing plan or trademark, along with (2) a franchise fee.\(^{55}\)

A few states define “marketing plan” in their statutes.\(^{56}\) These states typically use language similar to the “marketing plan or system” factors found in Release 3-F of the California

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\(^{50}\) The issue whether control elements in a relationship are limited to or go beyond what is needed to protect the originator or putative franchisor’s trademark, may arise in the context of a case asserting or defending the claim that a business relationship is a franchise, and also in cases of vicarious liability in which a plaintiff is seeking to hold a franchisor liable for incidents or events at a franchised location. See e.g., Patterson v. Domino’s Pizza, Inc., 333 P.3d 723 (Cal. 2014).

\(^{51}\) The following states have state laws defining “franchise”: California, Connecticut, Georgia, Hawaii, Illinois, Indiana, Iowa, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin.

\(^{52}\) The following states contain “marketing plan” as an element: California, Connecticut, Georgia, Illinois, Indiana, Iowa, Maryland, Michigan, New York, North Dakota, Oregon, Rhode Island, Virginia, and Washington.

\(^{53}\) The following states use the community of interest prong: Hawaii, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, South Dakota, and Wisconsin.


\(^{56}\) The following states define “marketing plan” in their statute: Illinois, Iowa, Rhode Island, Washington.
agency that regulates franchising ("Release 3-F"). The factors comprising a marketing plan include:

1. prescribing or limiting resale prices;
2. restrictions on use of advertising or mail order business;
3. giving detailed directions and advice concerning operating techniques;
4. assigning an exclusive territory;
5. providing uniformity or distinctiveness of appearance;
6. limiting the sales of competitive products;
7. limiting the use of products
8. requiring approval of advertising and signs;
9. prohibiting engaging in other activities;
10. providing training sessions;
11. use of an operations manual; and
12. providing trade secrets.

The same factors are typically analyzed in other jurisdictions without specifically mentioning Release 3-F. California courts cite Release 3-F as authority, but do not focus on Release 3-F in their analysis.

In Iowa, Rhode Island and Washington, statutes identify conduct that characterizes a marketing plan. The statutes read:

"Marketing plan" means a plan or system concerning an aspect of conducting business. A marketing plan may include one or more of the following:

(a) Price specifications, special pricing systems or discount plans;
(b) Sales or display equipment or merchandising devices;

57 In California, franchising is regulated by the Department of Business Oversight. Its predecessor, when Release 3-F was issued, was the Department of Corporations. Release 3-F is a guideline to help individuals interpret the definition of "franchise" under the California Franchise Investment Law, Cal. Corp. Code Secs. 31000 et seq., and the California Franchise Relations Act, Cal. Bus. & Prof. Code Secs. 20000 et seq. Release 3-F is accessible online at www.dbo.ca.gov/Commissioner/Releases/3-F.asp.

(c) Sales techniques;
(d) Promotional or advertising materials or cooperative advertising;
(e) Training regarding the promotion, operation, or management of the business; or
(f) Operational, managerial, technical, or financial guidelines or assistance.\(^5\)

The Washington statute omits the word "material," and states that a marketing plan may include one or more of the indicators listed. The Illinois Act reads similarly; however, training and providing operational, managerial, technical, or financial guidelines or assistance is not included in its statutory definition.\(^6\)

While many states use one or a combination of the above "marketing plan" definitions in their statutes, the following states do not provide a statutory definition for the term "marketing plan:" Virginia, Oregon, North Dakota, Michigan, and Indiana. This has left further interpretation to the courts to determine the qualifying activities.

F. Case Law Interpreting "Marketing Plan;" Conduct Constituting a Marketing Plan

Generally, courts interpret franchise statutes broadly to ensure protection is afforded when necessary.\(^6\) However, the "marketing plan" element is fact sensitive, and cases provide helpful guidelines for structuring future commercial relationships.

Typically, supplying required manuals or supplies will result in the presence of a marketing plan. For example, Virginia courts have construed operational and distribution plans provided by alleged franchisors as marketing plans.\(^6\) In *Aristacar Corp. v. Attorney General*,\(^6\) the court notes that the phrase "material aspect" is included with regard to conducting business.


63 541 N.Y.S.2d 165 (N.Y. 1989) (holding that a car service company was a franchisee).
the court found that supplying alleged franchisees with radio equipment, customers, and billing services, and dictating dress code, and the type of car to be driven, qualified as a marketing plan. Similarly, interpreting the California Franchise Relations Act, the Ninth Circuit found a marketing plan was established based on evidence that the franchisor provided the franchisee with sales directions and sales requirements.64

Master Abrasives Corp. v. Williams65 also laid out a list of activities that would be a marketing plan. The Indiana court noted that although the term marketing plan was not mentioned in the parties' agreement, the presence of exclusive marketing areas, right to approve hiring of sales employees, mandatory sales training, required sales quotas, and policies dictating how to attract customers was enough to establish that a marketing plan was prescribed by the alleged franchisor.66

The Master Abrasives factors have guided Indiana courts to detect the existence of marketing plans. For example, the Indiana Court of Appeals recognized the absence of Master Abrasives factors in Horner v. Tilton67 and concluded that the alleged franchisee's ability to use a different name than the one provided by the alleged franchisor combined with lack of "oversight" in marketing activities did not satisfy the marketing plan element. In Hoosier Penn Oil Co. v. Ashland Oil Co.,68 the court found no marketing plan existed when non-exclusive marketing areas were provided by the alleged franchisor, franchisor did not control the hiring of sales staff, a minimum sales requirement was in place but no sales quota, and training was offered but not required. The difference in factors appear subtle—e.g., the exclusive marketing territories in Master Abrasives versus non-exclusive marketing territories on Hoosier Penn Oil—but created opposite conclusions.

Connecticut courts have delineated factors to help detect the existence of marketing plans. The Connecticut federal district court listed "control over hours and days of operation, advertising, financial support, auditing of books, inspection of premises, control over lighting, employee uniforms, prices, trading stamps, hiring, sales quotas and management training" as factors for consideration when determining the existence of a marketing plan.69

64 Boat & Motor Mart v. Sea Ray Boats, Inc., 825 F.2d 1285 (9th Cir. 1987). See also Patterson v. Domino’s Pizza, LLC, 333 P.3d 723 (Cal. 2014) (finding the marketing plan requirement fulfilled where franchisor provides franchisee with a business plan requiring the franchisee to follow system standards and procedures, involving those areas such as marketing, production, operations, and administrative).


66 Id. at 1199–1200. See also Ayers v. Marathon Ashland Petroleum LLC, No. 103CV1780RLYTAB, 2005 WL 2428205, at *1 (S.D. Ind. Sept. 30, 2005) (noting the non-exhaustive list of activities in Master Abrasives, and finding that a reasonable jury could conclude that plaintiffs were operating under a marketing plan).

67 650 N.E.2d 759 (Ind. Ct. App. 1995). But see Ayers (similarly noting the absence of the Master Abrasives factors and nevertheless finding a marketing plan present).

68 934 F.2d 882, 887–86 (7th Cir. 1991).

69 Chem–Tek, Inc. v. General Motors Corp., 816 F. Supp. 123, 129 (D. Conn. 1993). See also Dittman & Greer, Inc. v. Chromalox, Inc., No. 3:09-CV-1147CFD, 2009 WL 3254481, at *2 (D. Conn. Oct. 6, 2009) (noting the factors that the Connecticut Supreme Court has set forth to guide a "marketing plan" analysis, "including whether the franchisor controlled the hours and days of operation, advertising, lighting, employee uniforms, prices, trading stamps, hiring, sales quotas, and management training, as well as whether the franchisor provided financial support to the franchisee, audited its books, or inspected its premises.")
In Lockard v. Milex Products, Inc., the Ohio Court of Appeals found the following requirements, taken together, amount to "extensive control," establishing a marketing plan under Illinois law: (1) required product prices; (2) a specific number of sales representatives per region; (3) compliance with all national policies; and (4) full-time focus on the development and sale of the alleged franchisor’s products.

G. Conduct That Does Not Constitute a “Marketing Plan”

A federal court in Connecticut found that instructions regarding training, display of products, and product promotion did not rise to the threshold of a marketing plan when the alleged franchisee carried brands other than the alleged franchisor’s brands. In addition, under Michigan law, offering special sales, deals, or exclusive access to new products would not likely amount to a marketing plan.

In a case concerning the relationship between a Missouri distributor and the well-known appliance manufacturer, Whirlpool Corporation, the Missouri federal court did not find a marketing plan existed even when Whirlpool provided the products to be sold and supplied standard policies and procedures because the distributor was expected to create its own marketing processes, train its employees any way it preferred, and control its every day operations.

In Kennedy v. Lomei, the New York Supreme Court, Appellate Division, held that a franchise relationship was not present—and no marketing plan existed—between a bakery and a baked goods wholesaler. No evidence of a marketing plan existed because the wholesaler "in no way regulated or controlled [the bakery’s] sales activities," and only fifty percent of products sold by the bakery were provided by the wholesaler.

In Edmands v. CUNO, Inc., the Connecticut court found no marketing plan existed under the Connecticut Franchise Act after analyzing the distributor’s annual sales action plan, the manufacturer’s control over price structure, hiring and firing practices, and inventory control.


72 Rzepka v. Michael, 431 N.W.2d 441 (Mich. Ct. App. 1988) (offering a “purchase option” that enabled plaintiff to have first option for a book sale did not qualify as a marketing plan).


75 Id.

mechanisms. The manufacturer did not have control over the pricing scheme, did not monitor or assist with inventory, and did not partake in hiring or firing the distributor's employees. Thus, no marketing plan was present between the parties.

In *Richard I. Spiece Sales Co., Inc. v. Levi Strauss North America*,78 the Indiana Court of Appeals upheld the district court's holding that no franchise relationship was present because a marketing plan was not prescribed by the defendant.79 The defendant had no control over products sold by plaintiff. The defendant suggested, but did not require, particular advertising methods. The plaintiff argued that it had to comply with the defendant's terms and conditions, and the defendant had to approve all marketing materials. However, the court found that the lack of control over advertising, pricing, and products sold indicated the lack of a marketing plan.80

In *Dittman & Greer, Inc. v. Chromalox, Inc.*,81 the Connecticut federal court found that there was no marketing plan "substantially prescribed" by the defendant as required by the Connecticut Franchise Act.82 The plaintiff argued that the defendant set prices and inventory levels, annual sales quotas and required specific training programs for sales employees.83 The defendant contended that annual sales quotas were goals and recommendations. The court noted that setting prices or inventory was not enough to establish that a marketing plan was prescribed by the defendant.

Some activities, such as consulting, have been found insufficient to constitute a marketing plan. For example, a Florida court interpreting the Illinois Franchise Disclosure Act held that a marketing plan was not present when the alleged franchisor offered access to training and training materials, but did not control the chiropractic services performed by the alleged franchisee. Instead, the alleged franchisor was consulting on how to operate a more effective business.84

Companies providing services to increase productivity have also avoided the "marketing plan" label. For example, a company that offered "1-800" numbers to businesses and diverted customer calls to the business was not a marketing plan because it did not control the alleged

77 Id. at *5.
79 Id. at 357.
80 Id.
82 Id. at *2.
83 Id. at *4.
franchisee's operations in any way, and only helped generate and supply the business with customers. 85

Further, courts have determined that the mere act of transporting goods for another company, does not establish marketing activities amounting to a marketing plan. In East Wind Exp., Inc. v. Airborne Freight Corp., 86 a Washington court held that a company that did not market or sell a service to individual customers, but rather transported packages, was not a franchisee. Similarly, a California federal court ruled that no franchise existed between a delivery company and Sears, although the delivery company's method of operation was determined by Sears, and its trucks were painted according to Sears's requirements. 87 The court stated no franchise existed because packages were being delivered for Sears, but no packages were sold under a marketing plan dictated by Sears.

H. Community of Interest Element; States That Use “Community of Interest” In Their Definition of “Franchise”

In at least eight states the existence of a franchise depends on whether there is a “community of interest” between the alleged franchisor and franchisee. Statutes in Hawaii, 88 Minnesota, 89 Mississippi, 90 Missouri, 91 Nebraska, 92 New Jersey, 93 Utah 94 and Wisconsin 95 include “community of interest” as a definitional element. In these states, the fee and trademark association elements are still present. But the marketing plan element is replaced with the requirement that there be a “community of interest” between the parties. Analyzing the existence of a franchise under these states' laws requires analysis of the "community of interest" test.

Whether a statute defines a franchise based on a "marketing plan" or "community of interest" can be significant. Indiana has an unfair practices statute that governs motor vehicle franchises and defines “franchise” based on a community of interest. 96 Indiana has a separate


88 HAW. REV. STAT. § 482E-2.

89 MINN. STAT. § 80C.01(4).

90 MISS. CODE ANN. § 75-24-51(6).

91 MO. REV. STAT. § 407.400(1).

92 NEB. REV. STAT. § 87-402(1).

93 N.J. STAT. ANN. § 56:10-3.

94 UTAH CODE § 41-2-102(16).

95 WIS. STAT. § 135.02(3)(a).

Franchise Act that defines “franchise” based on the existence of a “marketing plan.”

Thus, in the same state, two different statutes define the existence of a franchise differently. In a 2016 decision, *Ervin Equipment v. Wabash National Corp.*, a federal court in Indiana considered whether a business relationship met the definition of a franchise under each of these statutes.

A semitrailer manufacturer (Wabash) granted a dealership. The dealer (Ervin Equipment, Inc.) made sales both inside and outside its designated area of responsibility. The supplier gave notice of termination to the dealer. The dealer sued, claiming violation of both the unfair practices statute and Indiana Franchise Act. The court ruled that the relationship was possibly a franchise under the unfair practices act, finding there was a “community of interest” between the parties. A large portion of the dealer’s revenues came from the dealership and the dealer made a sizable investment specialized to the goods and not fully recoverable on termination. But the dealer agreement said the dealer controls its business and decisions, including pricing and marketing. Therefore, the court determined there was not a marketing plan and the relationship was not a franchise under the Indiana Franchise Act. This decision illustrates that the determination whether a relationship is a franchise can vary depending on whether the marketing plan or community of interest test applies.

I. **Challenges in Defining “Community of Interest”**

Generally, the statutes do not define “community of interest,” or if they do, the definition is in vague or general terms. For example, the New Jersey Franchise Practices Act contains “community of interest” as an element, but does not define the phrase. The Hawaii statute defines the phrase as “a continuing financial interest between the franchisor and franchisee in the operation of the franchise business.” Wisconsin defines the phrase similarly, as “a continuing financial interest between the grantor and grantee in either the operation of the dealership business or the marketing of such goods or services.”

No single definition or consensus has emerged as to what is a “community of interest.” Different states and different courts define the phrase differently. The definitions involve vague, subjective terms, which one court has said are “hardly crisp standards.” The Wisconsin Supreme Court, commenting on the Wisconsin Fair Dealership Law, called the “community of interest” element “troublesome,” and added that it “has been difficult to delimit with any precision.”

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99 See, e.g., *C & J Delivery, Inc. v. Emery Air Freight Corp.*, 647 F. Supp. 867, 872 (E.D. Mo. 1986) (noting, “unlike the Wisconsin franchise statute ... Missouri’s franchise statute does not contain a definition for ‘community of interest.’”). *See also Missouri Beverage Co. v. Shelton Bros.*, 769 F. Supp. 2d 988, 995 (W.D. Mo. 2011), aff’d, 669 F.3d 873 (8th Cir. 2012) (discussing what the courts would likely interpret “community of interest” to mean).


101 Wis. Stat. § 135.02(1).


103 *Ziegler Co., Inc. v. Rexnord, Inc.*, 407 N.W.2d 873, 877 (Wis. 1987). *See also Central Corp. v. Research Products Corp.*, 681 N.W.2d 178, 187 (Wis. 2004) (“community of interest” language is “vexing,” because it “has not resulted in the development of a bright line rule.”).
community of interest definition as “vague and unhelpful,” stating that it “permits no ready way in which to differentiate a dealership from any ordinary vendor/vendee relationship.” Recently, a federal court in Wisconsin referred to the law in this area as “muddled.”

Broadly speaking, at least three different definitions or modes of analysis have emerged. These are described below.

J. **The Two-Factor Community of Interest Test**

The Seventh Circuit, looking to the Wisconsin Fair Dealership Act, defined a community of interest to exist under one of two circumstances. The court stated:

Our cases have distilled the principles underlying the Wisconsin cases, and provide that a community of interest may exist under one of two circumstances: first, when a large proportion of an alleged dealer’s revenues are derived from the dealership, and, second, when the alleged dealer has made sizable investments (in, for example, fixed assets, inventory, advertising, training) specialized in some way to the grantor’s goods or services, and hence not fully recoverable upon termination.

To broaden the scope of relationships that may be found to have a community of interest, the Seventh Circuit also considered “that some combination of revenues and investments could manifest a community of interest, even if neither could standing alone.”

The Seventh Circuit found one more factor to be significant in determining if a community of interest is present:

[A] retailer is a dealer only if it has made the kind of investments that would tempt an unscrupulous grantor to engage in opportunistic behavior—in other words, to exploit the fear of termination that naturally attends a dealer’s investment in grantor—specific assets.... At root, these are two ways of saying the same thing. A grantor can exploit a dealer’s fear of termination (our words) only if termination will have severe economic consequences (their words). Severe economic consequences will attend termination (theirs) because the dealer will be unable to recover its sunk costs (ours).

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104 Frieberg Farm Equip. Inc. v. Van Dale, Inc., 978 F.2d 395, 398 (7th Cir. 1992). See also Ervin Equip. Inc. v. Wabash Nat'l Corp., 187 F. Supp. 3d 968, 975 (N.D. Ind. 2016) (stating that although “community of interest” is undefined, the “[S]eventh Circuit has interpreted this term in the context of the very similar Wisconsin Fair Dealership Law.”).


107 Frieberg Farm Equipment, 978 F.2d at 399.

Under this test, a party seeking to prove the existence of a community of interest would assert that a large proportion of an alleged dealer's revenues come from the dealership, or that the dealer has made a large investment in fixed assets, inventory, advertising, training specialized to the goods or services involved. To succeed, the plaintiff must assert that the sales or investment are so large that the putative dealer faces risk of great loss (severe economic consequences) in a termination of the relationship because the dealer could not recover its sunk costs.

Under the totality of the circumstances test, sales of a particular supplier's products representing as little as 11% of the dealer's revenue have been held to be sufficient proportion to establish a community of interest. The Wisconsin Supreme Court stated that a "low percentage," such as 8%, is strong evidence that there is no community of interest, at least absent other indicia, such as a dealer's investment in the dealership.

In a recent case, a private arbitrator found that a supplier and a distributor did not have a community of interest because they had the opposite—a "fundamental conflict of interest." This arose because the parties had different sales priorities. Earlier a Wisconsin federal district court had noted that conflicts can exist between parties without precluding the existence of a community of interest. "Whatever the phrase 'community of interest' may mean, it does not mean the absence of serious conflict between the parties or a complete agreement on a strategic vision and perfect alignment of interests and goals. Even within the same organization it is difficult to find such agreement and cooperation."

**K. Four-Factor Balancing Test for Community of Interest**

This test characterizes the community of interest analysis as a balancing test in which a court considers (1) the alleged franchisor's control over the alleged franchisee; (2) the franchisee's economic dependence on the franchisor; (3) disparity in bargaining power; and (4) presence of a franchise specific investment by the franchisee.

In *Instructional Systems, Inc. v. Computer Curriculum Corp.*, the New Jersey Supreme Court ruled that a franchisee and franchisor had a community of interest where the franchisee sold only the franchisor's product, was prohibited by the agreement to sell competing products, prohibited by the agreement to sell competing products,

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106 Frieberg Farm Equipment, 978 F.2d at 400.

109 Ziegler Co., Inc. v. Rexnord, 407 N.W.2d 873, 880 (Wis. 1987) (1%-8% sufficient); Kealy Pharmacy & Home Care Servs., Inc. v. Walgreen Co., 761 F.2d 345, 349-50 & n.6 (7th Cir. 1985) (6%-8% sufficient); Kenosha Liquor Co. v. Heublein, 895 F.2d 418, 420 (7th Cir. 1989) (8% not sufficient absent other Ziegler factors, particularly investment in firm-specific assets); Fleet Wholesale Supply Co., Inc. v. Remington Arms Co., Inc., 846 F.2d 1095, 1097-98 (7th Cir. 1988) (0.5% not sufficient under similar circumstances). See also Kelley Supply, Inc. v. Chr. Hansen, Inc., No. 2011AP233, 2012 WL 612802 (Wis. Ct. App. Feb. 28, 2012) (relying heavily on Ziegler when discussing the lower court's finding of a community of interest between the parties).


made significant franchise specific investments and jointly cooperated with the franchisor in sales, marketing and maintenance activities.\textsuperscript{115} The decision is illustrative of the New Jersey approach that focuses on the relationship's symbiotic character, measured by the size of the dealer's investment and whether the investment is firm specific and sunk. This reflects the New Jersey courts' perception that a "true franchise arrangement" is characterized by "vulnerability of the alleged franchisee to an unconscionable loss of tangible and intangible equities."\textsuperscript{116}

In contrast, in \textit{Cassidy Podell Lynch, Inc. v. SnyderGeneral Corp.},\textsuperscript{117} the Third Circuit found there was no community of interest where the investment in skills and customer base associated with the franchisor were transferable to future business endeavors.\textsuperscript{118} In another case, the Third Circuit found there was no community of interest where a retailer relied and could continue to rely on suppliers other than the alleged franchisor and had not been required to make a franchise specific investment.\textsuperscript{119} In an early seminal decision on community of interest, \textit{Neptune T.V. & Appliances v. Litton Systems},\textsuperscript{120} the New Jersey court found there was no community of interest where a purported franchisee obtained only 38% of its revenue from products associated with the alleged franchisor.\textsuperscript{121}

In the case of \textit{Orologio of Short Hills, Inc. v. The Swatch Group},\textsuperscript{122} the Third Circuit found no community of interest in a relationship between a manufacturer and retail dealer of high-end wrist watches. The dealer obtained watches from a number of sources. Its business "thrived" after being terminated by the manufacturer, "making it clear" in the court's view that the dealer was not economically dependent on the manufacturer. There was no franchise specific investment because the manufacturer offered to buy back existing inventory after the dealer was terminated. The dealer's investment in marketing, advertising and training did not persuade the court because "some amount of marketing and advertising investments are par for the course for any store that sells products manufactured by a supplier and we decline to hold that—without more—marketing the items on the shelf is sufficient to create a community of interest."\textsuperscript{123} The court found "no significant level of control" over the dealer. Any rules and

\begin{itemize}
\item \textsuperscript{115} \textit{Id.} at 140–46.
\item \textsuperscript{117} 944 F.2d 1131, 1140 (3d Cir. 1991).
\item \textsuperscript{118} \textit{Id.} at 1144. \textit{But see Ocean City Exp. Co. v. Atlas Van Lines, Inc.}, No. CIV. 13-1467 JBS/KMW, 2014 WL 654589, at *4 (D.N.J. Feb. 19, 2014) (citing \textit{Cassidy} and finding "a community of interest exists because Plaintiffs 'substantial franchise-specific investments' were 'required' by the parties' agreement.").
\item \textsuperscript{120} 462 A.2d 595 (N.J. App. 1983).
\item \textsuperscript{121} \textit{Id.} at 597.
\item \textsuperscript{122} 653 F. App'x 134 (3d Cir. 2016) (unpublished).
\item \textsuperscript{123} \textit{Id.} at 140.
\end{itemize}
limitations imposed on the dealer were not so burdensome as to create the unfettered control typically present in a franchise.\textsuperscript{124}

L. **Multi-Factor Community of Interest Test**

In a seminal community of interest decision, the Wisconsin Supreme Court noted in \textit{Ziegler Co., Inc. v. Rexnord} that the legislature “consciously defined the phrase community of interest to encompass an extraordinarily diverse set of business relationships not limited to the traditional franchise.”\textsuperscript{125} The court listed ten factors to be considered in evaluating whether a community of interest exists. They said the inquiry “must examine a wide variety of facets, individually and in their totality.” Factors to be examined include:

(1) whether the parties have a continuing financial interest in the business relationship;
(2) level of interdependence of the relationship;
(3) how long the parties dealt with each other;
(4) extent and nature of obligations imposed on parties in the agreement;
(5) percentage of time or revenue devoted by dealer to grantor’s products or services;
(6) percentage of proceeds or profits dealer derives from grantor’s products or services;
(7) extent and nature of grantor’s grant of territory to dealer;
(8) extent and nature of dealer’s uses of grantor’s marks (such as trademarks or logos);
(9) extent and nature of dealer’s financial investment in inventory, facilities, and goodwill of dealership;
(10) personnel which dealer devotes to alleged dealership;
(11) how much dealer spends on advertising or promotion for grantor’s products or services; and
(12) extent and nature of supplementary services provided by dealer to consumers of grantor’s products or services.\textsuperscript{120}

\textsuperscript{124} Id. at 141.

\textsuperscript{125} \textit{Ziegler Co., Inc. v. Rexnord}, 407 N.W.2d 873, 878 (Wis. 1987).

\textsuperscript{126} Id. at 879–80 (Wis. 1987). See also \textit{Girl Scouts of Manitou Council, Inc. v. Girl Scouts of U.S. of America, Inc.}, 549 F.3d 1079, 1093 (7th Cir. 2008) (considering these factors).
Courts note this list is not exhaustive. Other factors can also be considered. Subsequent decisions from Wisconsin have maintained this standard of analysis.

There are also Wisconsin decisions that reduce the above to a two-factor test, referred to by the court as "guideposts." These are (1) a shared financial interest in the operation of the dealership or the marketing of a good or service, and interdependence, or (2) the degree to which the dealer and grantor cooperate, coordinate their activities and share common goals in their business relationship.

Minnesota courts set a low threshold for finding a community of interest. Minnesota's seminal decision, Martin Investors, Inc. v. Vander Bie., found a community of interest to exist when parties derive fees from a common source, in that case, providing computer databank services matching borrowers and lenders, in which the alleged franchisor received a fee equal to 1% of the proceeds of each loan. The computer data bank was a common source of service provided by both the franchisor and franchisee, and the franchisor's right to 1% of the proceeds of each loan placed by the franchisee established a community of interest in marketing the services.

In the recent case of Cycle City Ltd. v. Harley-Davidson Motor Company, a federal court in Hawaii considered whether a community of interest might be present under Hawaii law in a dealer relationship for Harley-Davidson motorcycles. The dealer had a license to use Harley-Davidson's trademarks and paid royalties to Harley-Davidson for the sale of licensed products. The License Agreement gave Harley-Davidson the right to approve all licensed products, packaging and promotional materials. The dealer was required to get Harley-Davidson's approval before it could produce any licensed products. The License Agreement required the dealer to limit its sale of licensed products to only the Hawaii market and to use best efforts to advertise, promote, sell and distribute the licensed products. The dealer was obligated to buy all new motorcycles exclusively from Harley-Davidson. The dealer claimed that Harley-Davidson exercised substantial control over its sale and distribution of the licensed products. The dealer claimed to have made substantial investments in maintaining an inventory of products and in manufacture, advertising, sale, and distribution of products.

The court did not attempt to link particular facts to the various guideposts for finding a community of interest. Rather, after summarizing the allegations, the court stated "there is no precise line between when a company is simply a distributor of a manufacturer's trademarked

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127 See, e.g., Water Quality Store, LLC v. Dynasty Spas, Inc., 789 N.W.2d 595, 601 (Wis. 2013) (noting the factors are not exhaustive); Central Corp. v. Research Products Corp., 681 N.W.2d 178, 188 (Wis. 2004) (noting, while the "list does not recite every factor that may be considered, it does provide questions that are useful in determining whether a community of interest exists.").

128 See, e.g., Water Quality Store, LLC v. Dynasty Spas, Inc., 789 N.W.2d 595, 601 (Wis. 2013) (noting the factors); Central Corp. v. Research Products Corp., 681 N.W.2d 178, 188 (Wis. 2004) (repeating these factors).

129 See, e.g., Benson v. City of Madison, 897 N.W.2d 16, 30, n.15 (Wis. 2017) (adding that although the court had previously stated the longer list of considerations "should" be considered, "it is more accurate to say that some or all "may" be considered; the factors are meant to be a helpful aid in addressing the overriding community of interest question, not an unwieldy burden.").

130 269 N.W.2d 868 (Minn. 1978).

goods and when the company is a franchise. The mere licensing of a trademarked good, without more, does not give rise to a franchise relationship. How much more is required is a matter of degree.” The court ruled that there were sufficient allegations to present this question to the finder of fact.  

M. Community of Interest “Benefit” Test

Another test looks at whether one or the other party “benefitted” from certain aspects of the relationship. One court, in a case under Missouri’s franchise statute, ruled that a community of interest required, at a minimum, that 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.

The case concerned a local company (C & J) providing delivery service for a national package forwarding company (Emery). C & J did not solicit business from customers directly. C & J picked-up and delivered packages that customers consigned to Emery. C & J picked-up and delivered packages only if customers chose Emery for their delivery service. C & J’s business volume depended on Emery’s business. C & J prospered only if Emery generated business. The court found that C & J’s business was inextricably linked to Emery’s ability to market its service to customers, and Emery’s business depended on all its delivery companies, including C & J. Therefore the community of interest test was satisfied.

In a later case, another federal court in Missouri found the community of interest was not present in a beer distributorship. Applying the same test, the court added that the mutual benefit must be more than sharing of profits. The supplier gave the distributor logos of some beers to aid in selling them. But the distributor did not benefit from the supplier’s name such that the distributor could coopt goodwill and customer recognition of the brand. The distributor had a reputation distinct from the supplier so that it did not use the supplier’s goodwill to make sales. These facts indicated to the court that a community of interest was absent.

N. Other Tests to Determine if a “Community of Interest” is Present

The absence of a specific definition in a state’s statute can lead to unusual analyses. Tesla Motors UT, Inc. v. Utah Tax Commission concerned a car maker’s application for a license to sell its own brand of new cars. The application was submitted by Tesla Motors UT, Inc., a subsidiary of Tesla, Inc., the maker of popular all-electric vehicles. Utah, like many states, prohibits motor vehicle manufacturers from selling their own vehicles in stores, and Utah’s Franchise Act prohibits car makers from owning an interest in a new motor vehicle dealer. Utah’s License act requires a motor vehicle dealer to have a franchise for the brands it sells.

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132 Id. at *9.
135 Id. at 995.
136 Id.
137 398 P.3d 55 (Utah 2017).
Tesla entered into a dealership agreement with its subsidiary. Tesla sought to prove that the agreement was sufficient to grant authorization to the dealer to satisfy the License Act requirement, but that it did not meet the definition of a franchise under the Franchise Act, thereby avoiding the prohibition against the manufacturer owning an interest in the dealer. Utah's Licensing Act and Franchising Act defined "franchise" differently. The Franchise Act requires the presence of a "community of interest" in the marketing of new motor vehicles, while the Licensing Act does not. Rather, the Licensing Act merely defines a "franchise" as "a contract or agreement between a dealer and a manufacturer of new motor vehicles or its distributor or factory branch by which the dealer is authorized to sell any specified make or makes of new motor vehicles."\(^{138}\)

Tesla argued there was no "community" of interest because Tesla and its subsidiary were so closely aligned, and by having such an identity of interest, they were "too close to count as a community of interest."\(^{139}\) The Utah Supreme Court looked to a Merriam-Webster dictionary definition of "community" as a "unified body of individuals," a "group linked by a common policy," or a "body of persons or nations having a common history or common social, economic and political interests." The court said "the core characteristic of a 'community' is in their unity."\(^{140}\) The court ruled that while Tesla and its subsidiary were "distinct corporate entities," their "unity could not be clearer with respect to their interest in selling Tesla cars."\(^{141}\) The court found that a community of interest, therefore, existed.

The Tesla decision was not so much a definition, as a rejection of Tesla's effort to argue that the identity of interest in a relationship between a parent and wholly owned subsidiary could not comprise a "community," and thus precluded the existence of a "community of interest."

O. Relationships Labeled by Parties

The parties' label for a relationship will not bind the court, or persuade the court from finding the relationship to be a franchise. For example, a Connecticut court examined a landlord-tenant relationship to determine the presence of a marketing plan. The court articulated that the landlord's control over working hours and active monitoring of all advertising signs on the premises did not suffice to establish a marketing plan.\(^{142}\) However, in addition to the above facts, a different landlord's requirement that its tenant's employees wear uniforms combined

\(^{138}\) Id. at 63 (quoting UTAH CODE § 41-3-102(16) (2018)).

\(^{139}\) Id. at 63.

\(^{140}\) Id.

\(^{141}\) Id.

\(^{142}\) Consumers Petroleum of Connecticut, Inc. v. Duhan, 452 A.2d 123 (Conn. Super. Ct. 1982). But see Getty Petroleum Mktg., Inc. v. Tuli, No. CV 2110191, 2000 WL 893447, at *2 (Conn. Super. Ct. June 21, 2000) (finding that the lessor-lessee relationship constituted a marketing plan, and noting the following factors that courts look at to determine whether a marketing plan exists: "Factors to consider include the franchiser's power to hire and fire employees, power over pricing, control over inventory, the existence of a marketing plan, requiring the training of employees, and the power to examine financial records and to audit ... whether the franchisor establishes sales quotas, provides financial support and management training, requires employee uniforms, reserves the right to inspect the station, has ultimate control over the use of advertising signs, reserves the right to set prices, requires illumination of the premises, or hires the employees. Also, whether the rent is based on the gallons of gasoline sold and whether the franchiser sets the hours of operation.").
with the landlord's ability to review the tenant's books transformed the landlord-tenant relationship into a franchise relationship.143

In Shah v. Racetrac Petroleum Co.,144 the parties referred to their relationship as a lease, and stated in their contract that the arrangement did not create a franchise relationship. The court stated that the contract language did not bar a judicial determination that a franchise existed. The court stated "how the parties describe their relationship is irrelevant."145 In Englert, Inc. v. LeafGuard USA, Inc.,146 the court referenced a FTC advisory opinion as support for the proposition that a franchise relationship is "not dependent upon what the parties call the relationship."147 In U-Bake Rochester, LLC v. Utecht,148 the court determined that even if the statutory elements are met, a franchisee might still not be entitled to make a statutory claim if its attorneys agreed up front that the franchisee was actually not a franchisee.

While characterization of the relationship by the parties does not bind a court, it can still have some relevance. A federal district court in Michigan noted: "the word 'franchise' does not appear anywhere in the parties' agreement." While not dispositive, the court noted "it is clearly probative of what type of agreement was reached."149

At least one state—Illinois—has found a marketing plan exists if a franchisor merely suggests that the franchisees utilize standard procedures.150

V. IMPLICATIONS AND REMEDIES

As demonstrated above, whether a given relationship is a "franchise" obviously varies from jurisdiction to jurisdiction and is heavily dependent upon the words used by the legislature or agency at issue, the facts of the case, and, quite likely, the personal views of the judge deciding the case. This is more than an academic inquiry.


144 338 F.3d 557, 562 (6th Cir. 2003).

145 Id. at 575.


147 Id. at *3.


150 Chicago Male Med. Clinic, LLC v. Ultimate Mgmt., Inc., No. EDCV 13-00199 SJO, 2014 WL 7180549 (C.D. Cal. Dec. 16, 2014) ("Note that the IFDA [(Illinois Franchise Disclosure Act)] does not require that the marketing plan or system be binding on the party; rather, the system may be 'suggested in substantial part by a franchisor.'"); Blankenship v. Dialist Int'l Corp., 568 N.E.2d 503, 506–07 (Ill. App. Ct. 1991) (holding a marketing plan was present when "such a right was provided under the contract.").
Where all of the franchise elements are present, pre-sale registration or qualification for an exemption or other compliance is required. The failure to register and properly disclose under the FTC or applicable state law may result in the franchisee having an argument that the franchise was illegally sold, and the franchise may be entitled to statutory rescission or common law rescission, and/or a claim for damages. Being an "accidental franchisee," can be very helpful to a failed business operator and very costly to the franchisor. If the operator has lost hundreds of thousands or even millions of dollars, the operator may be able to recover these losses on the basis that an unregistered franchise was sold, or, alternatively, that state law requires certain specific and material disclosures to be made to a prospective franchisee and those disclosures were never made to the failed operator.

In addition, the financially successful dealer or distributor who is really a "franchisee" under applicable law may have statutory anti-termination rights that make it difficult or impossible to terminate the franchisee without "good cause," proper pre-termination notice, and proper opportunity to cure any alleged deficiency in performance. This sort of "accidental franchise" is a boon to the successful operator, and a threat to a franchisor, because dealer agreements and distribution agreements often are of very short duration (for example, one year, three years, five years) and/or permit termination without cause by the manufacturer/supplier on very short notice (30 to 90 days). A dealer or distributor working under a one-year contract terminable on 30 days' notice will certainly be in a far more advantageous situation if he or she now has a contract that is terminable only for cause. In some states, a "franchisee" has the legal right to a perpetual contract that may never be terminated except for good cause.

VI. PRE-LITIGATION AND LITIGATION STRATEGIES AND TECHNIQUES

Given the significant legal rights and remedies that may be available to a "franchisee," litigators need to use various pre-litigation and litigation strategies and techniques to best represent both franchisors and franchisees.

When faced with challenges in the relationship, franchisors and franchisees must define the legal landscape. If an attorney is consulted prior to a contract termination or impending nonrenewal, the franchisor-side attorney should review the written agreement, emails, invoices and other documents related to an oral agreement or agreement created by course of dealing, and to review whether the party whose contract is being terminated or nonrenewed might be entitled to claim statutory protection. If it appears that the party whose contract is being terminated or nonrenewed may have statutory rights, the attorney should advise the client and create a termination or nonrenewal strategy.

For example, if a distributor with a one-year contract is about to expire, one possible strategy would be to advise the distributor that the contract is expiring and provide some financial or other incentive to the distributor to sign a release of claims. The distributor may be

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unaware of statutory rights and may believe that getting an “expiration plus” deal is better than getting nothing. Another way to handle a situation in a state with a broad definition of “franchisee” is to draft a contract that is consistent with the state law. For example, since Virginia’s Supreme Court has declared that the Virginia Retail Franchise Act protects only against termination and not against non-renewal,\(^{154}\) if a manufacturer/supplier has either no written contract or a contract of indefinite duration, it may make sense to work out a contract of definite duration (for example, two years) and allow the contract to “expire” (no statutory protection) rather than be “terminated” (possible statutory protection).

A. Ascertaining the Applicable Definition(s)

A key element of the landscape to be defined, is the threshold question, whether the relationship is or is not a franchise; that is whether all the elements of a franchise are present. This analysis starts with determining which definition or definitions apply. The FTC Rule has its definition, and various states each have their own. Counsel should assess which state or states may apply their franchise laws to the relationship.

While choice of law analysis is beyond the scope of this paper, generally the candidate states whose franchise laws may apply include the state identified in the applicable agreement’s choice of law provision, the state(s) where the franchisee or its owners are domiciled, the state where the franchisor is domiciled, the state(s) where the franchised business is located, the state(s) where the parties held meetings to discuss and negotiate the execution of a franchise agreement, and the state where the franchise agreement was signed and from which and to which it was transmitted between the franchisor and franchisee. Each of these state franchise laws should be consulted to ascertain (1) their provisions stating which transactions and relationships they apply to, and (2) their particular definitions. It is possible to have multiple state laws and therefore multiple definitions apply. Having determined which state laws may potentially apply, the definitional elements under each may then be considered.

B. Reviewing the Presence or Absence of Each Definitional Element

After ascertaining the applicable definitions, a next step is to review and list facts that may demonstrate the presence or absence of each element. As an example, if counsel is ascertaining the existence of a franchise under a definition whose elements are: (1) a marketing plan; (2) substantial association with franchisor’s trademark; and (3) a franchise fee, then counsel for a franchisor or franchisee might make a list of facts indicating the presence or absence of each element. Counsel for the franchisor is more interested in establishing the absence of each element. Counsel for the franchisee is more interested in establishing presence of each element. Thorough analysis requires each counsel to consider evidence of both the presence and absence of the elements. With these lists, counsel can assess the strength of the client’s contention about the presence or absence of a franchise.

One possible method for either franchisor or franchisee counsel to perform this analysis, is to first adopt a broad view, listing every fact or factor that might conceivably or potentially comprise each element. At this early stage of the analysis, indicia of a marketing plan might potentially include almost any and every aspect of the manner in which the putative franchisor operates that provides assistance or benefit to the putative franchisee. Under this initial broad

view, assistance and suggestions made to a distributor, sales aids, training, guidance, written materials, distributor's use of the supplier's brand, pricing strategy, even the product or service itself, are potentially to be listed as marketing plan elements. The trademark association, at first view, might consider every possible way in which the reseller, distributor or dealer is associated with or uses a supplier's brand or logo. With regard to the fee, the initial analysis, prior to refined examination, may consider every type of payment or financial consideration flowing from a dealer, distributor, reseller or representative, to the supplier or originator of a distribution program or to third parties for the benefit of the supplier or originator.

The above brainstorming analysis is to be followed by a refined examination, informed also by statutory and regulatory definitions and case law of the relevant jurisdictions. This is a stage where franchisor's counsel may look to law, regulations and cases to eliminate many of the potential marketing plan, trademark association and fee elements placed on the list. This exercise prepares the franchisor's counsel to respond to an aggressive claim made by the franchisee. Similarly, at this refinement stage, franchisee's counsel develops analysis why the elements placed on the list should not be eliminated by any statutory, regulatory or case law. Franchisee's counsel prepares at this stage to avoid or rebut the franchisor's argument against the existence of a franchise.

More is involved in addition to definitional analysis. Assessment of other aspects of the parties relationship may be in order.

For example, in situations where a franchisee has been sold an unregistered franchise or a franchise without statutorily-required disclosures, the franchisor's attorney should assess whether the franchisee is happy in the relationship and whether the franchisee has made or lost money. A happy franchisee that is making money may have no interest in rescission. A letter to such a franchisee stating that (1) the franchise was sold in a technically deficient manner, and (2) the franchisor would like to offer rescission, is unlikely to result in any problem for the franchisor. Conversely, when a franchisee has lost hundreds of thousands of dollars, that franchisee is far more likely to accept a rescission offer and demand significant compensation.

C. Exemption Analysis

Counsel's definitional analysis, discussed above, may indicate that all the definitional elements are present. Whether counsel represents a franchisor or franchisee, this is not the end of the analysis. Exemptions may be considered. Counsel who is concerned for the putative franchisor client that all the elements may be present, should consider whether any statutory or regulatory exemption, exception or exclusion may provide a defense to the claim that the relationship is a franchise. Counsel for the putative franchisee should also analyze exemptions, to assess the potential that the franchisor may be able to assert such a defense.

D. The "Accidental Franchisor"

The "accidental franchisor" may also need legal advice on how to deal with state regulatory authorities who may be very interested in the fact that at least one (and possibly multiple) unregistered franchises were sold in their states.

A franchisee attorney reviewing issues related to an accidental franchise must immediately determine applicable statutes of limitations. What are the common law and statutory statutes of limitation that may apply? Are they deemed to be "procedural" or "substantive?" For example, if Minnesota allows 6 years to sue for common law fraud and 3
years to sue for statutory violations, will those time periods be applied by a judge in Texas? By an arbitrator in Massachusetts? Is there a discovery rule under the state franchise law? Does the state franchise law contain non-waiver language, and will the judge or arbitrator in the chosen venue apply the law of the franchisee’s state if the law of the venue is the contractually-chosen law?

Assuming that no statutory or contractual period for bringing claims has yet expired, what remedy is the accidental franchisee seeking? The franchisee under most laws may seek rescission and/or damages. The franchisee may actually have a shorter period in which to bring a rescission claim because rescission claims are often seen as equitable claims and can be barred by "undue delay." An attorney reviewing a case where an unsuccessful franchisee is trying to get out of a system after, for example, 5 years, may want to make a claim for "damages" rather than rescission. However, making a claim for "damages" generally requires proof of causation. A court may take the position that a franchisee’s “damages" were not caused by the sale of the franchise, but, rather, by the poor operations of the franchisee. At least one court rejected the position that a franchisee who alleged a fraudulent sale of a franchise could reach trial because the court determined (on summary judgment) that the franchisee was a sub-par operator and caused his own damages.

In most “accidental franchise" cases, comprehensive contracts (as there would be in a well-established franchise system) may not exist. This may result in more arguments on issues such as choice-of-law and choice-of-venue, and even the terms of the relationship. Forum shopping considerations may be at play. For example, if the parties have no written contract or a very short outline, the franchisee may be able to sue the franchisor in the franchisee’s own state. However, if the federal courts in the franchisee’s state are conservative, the franchisee may prefer to sue the franchisor in state court in the franchisor’s back yard (where the franchisor has one less option to remove the case to federal court). If the potential state where a case can be brought has different statutes of limitation, there may or may not be an advantage to suing in a jurisdiction with a longer statute of limitation, even if that is not the franchisee’s primary place of business.

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155 In Johnson v. QFD, Inc., 807 N.W.2d 719, 722–23 (Mich. Ct. App. 2011), the question before the court was whether the statutory period of limitations was shortened by a one-year limitations term in the parties’ contract. Specifically, the contract provided "Purchaser understands and agrees that—if either of us should breach this contract—the other of us shall have one year, after the occurrence of that breach, in which to commence an action for a breach of contract." Id. at 723. The Mobile Home Commission Act (MHCA) had an internal three-year limitations period. Id. at 729. Ultimately, the court rendered the "[statutes'] three-year period of limitations controls plaintiffs' statutory claim for rescission and damages . . . ." Id. In 2004, one court found that a contractual 'one-year contractual limitations period for 'suits' [was] inapplicable to this arbitration proceeding” because arbitration is not a "suit." Vaubel Farms, Inc. v. Shelby Farmers Mut., 679 N.W.2d 407, 412 (Minn. Ct. App. 2004). In general, "the characterization of a statute of limitations as procedural or substantive greatly varies depending upon the context of the analysis." Wellington Homes, Inc. v. W. Dundee China Palace Rest., Inc., 984 N.E.2d 554, 563 (Ill. App. Ct. 2013).

156 See, e.g., Clapp, 327 N.W.2d at 587 (Minnesota Franchise Act’s statute of limitations was three years, but franchisee’s rescission claim barred due to undue delay of 22 months).


158 28 U.S.C. § 1441(b)(2) ("A civil action otherwise removable solely on the basis of the jurisdiction under section 1332(a) of this title [diversity of citizenship] may not be removed if any of the parties in interest properly joined and served as defendants is a citizen of the State is which such action is brought.")
E. **Termination Strategies**

If a manufacturer or supplier wants to terminate a very profitable dealer or distributor, it may be a bad idea to just send a termination notice. A franchisee who is wrongfully terminated may be able to claim somewhere between 5 and 20 years’ worth of “lost future profits” for the termination.\(^{159}\) Therefore, terminating a distributor who is making $500,000 in profit a year may result in a $2,000,000 to $10,000,000 damages award, plus attorneys’ fees and costs. It may be far safer for the manufacturer or supplier to commence a declaratory judgment action in its home state, asking the court to declare that the manufacturer/supplier has a legal right to terminate the contract at issue.\(^{160}\) This sort of action against an out-of-state franchisee can be commenced in federal court in the franchisor’s home town, generally the most favorable possible venue for the franchisor.

F. **Venue**

A franchisee who is sued out of state in an unfavorable venue may be able to achieve some leverage by making a complaint to a state regulator in its own state. While the franchisee might be bound by a choice of venue or arbitration clause, or beaten to the punch on a “first to file” basis, a state regulator is bound by none of these things. The fact that a Maryland or Hawaii franchisee might be stuck in front of a very unfavorable judge in Texas federal court may mean less if the franchisee can convince a Maryland or Hawaii regulator to demand that the franchisor comply with local law and provide a statutory remedy to the local franchisee.

VII. **CONCLUSION**

Fundamental to any field of endeavor are terms and definitions. In franchising and franchise law, the fundamental legal question is whether the relationship is or is not a franchise. Historically, this has been a challenge and a subject of extensive commentary\(^{161}\) because there has been no single definition of the term “franchise” and, as noted by one court, “commentators have offered conflicting advice as to how far law should regulate a dealership as a franchise.”\(^{162}\)

\(^{159}\) See *Kealey Pharmacy & Home Care Servs., Inc. v. Walgreen Co.*, 761 F.2d 345, 353 (7th Cir. 1985) (computing lost future profits by projecting an estimated 4% decline in the rate of increase of gross sales for plaintiff’s store in 1980–1981 over the twenty-year life of the store); see also *Randy’s Studebaker Sales, Inc. v. Nissan Motor Corp. in U.S.A.*, 533 F.2d 510, 518 n.13 (10th Cir. 1976) (stating “[l]oss recovery is not necessarily limited to one year’s lost profits ...” and upholding a computation of a projected ten-year period of lost profits). But see *Trenhaile v. J.H. Findorff & Son, Inc.*, No. 02-2919, 2004 WL 1057601, at *1 (Wis. Ct. App. May 4, 2004) (citing *Kealey* and upholding the district court’s decision to not award compensation for lost future profits).

\(^{160}\) *Link-Belt Constr. Equip. Co., L.P., LLLP v. Rd. Mach. & Supplies Co.*, No. CV 10-103-KSF, 2011 WL 13122221, at *1 (E.D. Ky. Apr. 15, 2011) (stating that even though the dealer would have been entitled to Minnesota statutory protection, Kentucky courts would not recognize that protection where the agreement chose Kentucky law).


\(^{162}\) *Boat & Motor Mart v. Sea Ray Boats*, 825 F.2d 1285, 1287 (9th Cir. 1987).
Key to litigating the existence of a franchise is to identify the laws that apply, the definitions contained in those laws, and the elements of a franchise comprising those definitions. Counsel and clients must then identify and collect the evidence that proves the presence or absence of each of those elements. The party who will carry the day is the party who can more persuasively show either that all the elements are present, or that at least one of the elements necessary to the existence of a franchise is absent.
VIII. APPENDIX—Table Showing Which Elements are Required in Which States

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>FTC Rule</th>
<th>Fee</th>
<th>Trademark</th>
<th>Marketing Plan</th>
<th>Community of Interest</th>
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\textsuperscript{163} Delaware law is unclear on what standard a court would use to determine the existence of a franchise.
<table>
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<tr>
<th>Jurisdiction</th>
<th>Element Required or Not Required For Franchise To Exist Under State's Definition</th>
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<th>Trademark</th>
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<td>Franchise Practice Act, NEB. REV. STAT. Sec. 87-402(1).</td>
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<td>N.Y. GEN.BUS. LAW § 881.3.</td>
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^164 Massachusetts law is unclear on what standard a court would use to determine the existence of a franchise.

^165 Nevada law is unclear on what standard a court would use to determine the existence of a franchise.

^166 The New York statute requires only the existence of either a marketing plan or grant of trademark rights paired with the payment of a franchise fee to establish a franchise relationship.
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<tr>
<th>Jurisdiction</th>
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<th>Statute</th>
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167 North Carolina law is unclear on what standard a court would use to determine the existence of a franchise.

168 Vermont law is unclear on what standard a court would use to determine the existence of a franchise.
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</table>

169 West Virginia law is unclear on what standard a court would use to determine the existence of a franchise.

170 Wyoming law is unclear on what standard a court would use to determine the existence of a franchise.
David Gurnick

David Gurnick is with the Lewitt Hackman firm in Los Angeles, California. He represents manufacturers, franchisors, cooperatives, distributors, dealers and franchisees in wide ranging industries in preparation of distribution agreements, franchise law compliance, antitrust and competition matters, government investigations, trademarks, copyrights, trade secrets, e-commerce and related litigation. He is certified by the State Bar of California, Board of Legal Specialization as a specialist in Franchising and Distribution Law.


David served as adjunct professor of law, teaching franchising at the University of LaVerne College of Law. He has frequently been a panelist at the American Bar Association Forum on Franchising, and International Franchise Association Legal Symposium. David previously served on the editorial board of the American Bar Association Franchise Law Journal.

He is a past president of the San Fernando Valley Bar Association, and past chair of its Business Law Section and its Litigation Section. He served as trustee of the University of West Los Angeles College of Law, and was president of the Valley Community Legal Foundation, as well as trustee of the Los Angeles County Bar Association. He is currently on the board of directors of the Valley Bar Mediation Center, a charity that provides low cost mediation and dispute resolution services.

David is admitted in the U.S. Supreme Court, U.S. Courts of Appeals for the Federal Circuit and Ninth Circuit, and U.S. District Courts for the Central District and Eastern District of California. He earned his Bachelor's Degree in 1981 at UCLA graduating summa cum laude and Phi Beta Kappa and his law degree in 1984 at the University California, Berkeley. While in law school, he served as Judicial Extern to the U.S. Ninth Circuit Court of Appeals.
Jeffery S. Haff

Jeffery S. Haff is a partner at Dady & Gardner, P.A. in Minneapolis, Minnesota. In his nearly 30 years of practice, Jeff has represented franchisees, dealers and distributors throughout the United States. Jeff has been honored with numerous accolades, including:

- Being named one of the "Best Lawyers in America" in the field of Franchise Law every year since 2010.
- Being named a Minnesota "Super Lawyer" every year since 2002.
- Being named a "Legal Eagle" by Franchise Times on numerous occasions.

Over his career, Jeff has achieved millions of dollars of settlements and awards for wronged dealers, distributors and franchisees. Jeff is regularly called upon to provide the franchisee perspective in speeches at legal conventions and symposiums.

Jeff was one of 20 Presidential Honors Scholars in his graduating class at the State University of New York at Buffalo (B.A. summa cum laude 1986). Jeff graduated from the prestigious Duke University School of Law (J.D. With Honors 1989). Jeff is married with three children, and he lives in Maple Grove, Minnesota.

Craig Miller

Craig Miller is a shareholder with the law firm of Gray Plant Mooty Mooty & Bennett, P.A. in Minneapolis, Minnesota. In his 22 years of practice, Craig has practiced primarily in the areas of franchise and distribution litigation. As a litigator, Craig represents companies and individuals in trial, arbitration, and other civil proceedings throughout the United States. He has represented clients in a wide variety of matters, including franchise disputes, complex business fraud actions, trademark and trade dress infringement, non-compete enforcement, and unfair trade practices claims. Craig is experienced in guiding clients through the dispute resolution process, whether through litigation, arbitration, mediation, or negotiation.

During his career, Craig has been named as a Minnesota "Rising Star" (for the years 2002, 2005-2006), a Minnesota "Super Lawyer" (for the years 2014 through 2018), and was listed in the "International Who's Who of Franchise Lawyers" in 2017 and 2018.

Craig is admitted in the U.S. Courts of Appeals for the Seventh and Eight Circuits, and the United States District Courts for the District of Minnesota and the Eastern and Western Districts of Wisconsin. Craig earned his law degree from the University of Wisconsin in 1996. He enjoys spending time with his significant other, and their 2 year old son, who keeps them very active and busy.