Today’s Presentation

Franchise Litigation:

- Elements of a franchise
- Context of litigation
- Franchise agreements
- Other/Similar agreements
- Litigating the elements
- Proving presence/absence of elements
Importance of Elements

Why Is This Subject Important?

- Determining the relationship
- Presence/Absence of elements
- Franchise Disclosure Documents
- Franchise registration
- Terminations
- Avoiding terminations or obtaining monetary relief
Elements of a Franchise

Different Laws, Different Definitions

- Federal Trade Commission Rule
- State definitions
Elements of a Franchise

Elements (generally, but not always)

- Franchise fee
- Trademark use or association
- Substantial control / marketing plan / community of interest
- Two elements in New York
Definition:

Under NY law, a franchise relationship exists if just two elements are present:

1. the existence of either a marketing plan or trademark and
2. a franchise fee.
Looks Like a Duck
“Looks like a duck and walks like a duck and quacks like a duck” then it is probably a duck.

- and -

“It must be a duck . . . even if it is holding a piece of paper that says it is a chicken.”

See, e.g., Zebel, LLC v. U.S.

FTC Rule on “Franchise Fee”:

(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.
FTC Rule on “Franchise Fee”:

- Fee = $570 (indexed for inflation) paid within 180 days of signing the FA.
- The FTC Rule uses “required payment,” not “franchise fee.”
- Implication - all payments qualify except for “payments for the purchase of reasonable amounts of inventory at bona fide wholesale prices for resale or lease.”
No Magic Words

FTC Rule on “Franchise Fee”:

- No magic word or words.
- Fee has been called “consulting fees” “license fee,” “training fee,” “site assistance fee,” "administrative fee," "management fee" “partnership fee,” “joint venture fee,” etc.
- Key: Is fee for the right to obtain or commence operation of business?
Wide Variety of Case Law

Metro All Snax, Inc. v. All Snax, Inc., (D. Minn. 1996)
Snack food and novelties distributor paid a training fee.

Rogovsky Enter., Inc. v. Masterbrand Cabinets, Inc., (D. Minn. 2015)
$300,000 for improving cabinet showroom, not a franchise fee.

Expenses re: marketing/legislative fund, training, local ads, and required purchases of in-store décor and marketing materials - not franchise fees;
Minimum purchase requirement & business-related payments like a dedicated phone line may be a “franchise fee.”

Part of “zone price scheme” may have also been to operate an *am pm* store, since the gas station owner could not have one without the other.
And on the Flip Side

- Cases that use these standards – “Received something of value” “Unrecoverable investment” “Ordinary business expense”
- A useful analysis?
- Training fee? Payment for any franchisor service?
Q - Who here tells franchisee prospects that the up-front fee and payments for franchisor services are, “Investments you’ll never get back?”
Read Your State Statutes!

- Example - Associates & Civil Procedure.
- Many state laws have *de minimis* exemptions for fees.
- Other states do not require a fee.
- In MN: Fee + Distributor = Franchisee.
Practical Issues

- Is there established body of state case law?
- If not, does your Judge think you should win?
- Examples:
  
  1) “You didn’t fail because of fraud. You failed because you lost money.”
  
  2) “Your lawyers said it wasn’t a franchise....”
Equitable Arguments

Arguing for a Franchise Fee:

- I clearly paid it; I didn’t want to do so.
- Franchisor got the benefit and did little or nothing for me.
- They’re trying to get around the law!!
Arguments Against a Franchise Fee:

- Just a business expense any business would have for tangible/intangible item.
- They admitted it isn’t a franchise (fee)! (Argument worked in 3 cases cited in our paper.)
Arguments Against a Franchise Fee:

- Result of finding a “franchise/franchise fee”:
  1. Perpetual/infinite franchise agreement
  2. Reward of a terrible operator for his own negligence/stupidity.
Hypothetical – Making distributor buy low-cost promotion items to give to customers.
Trademarks

Proving Existence of Trademark Association:

- Use of trademark
- Various IP can satisfy this element
- Wide-ranging uses
- Strategies of presenting evidence
Trademarks

Refuting and Defending TM Association:

- Association or substantial association
- Volume of business
- Use of other brands
- Use as a trademark
- Generic
Litigating Substantial Control

Large degree of control over the franchisee’s method of operation or significant assistance in the franchisee’s method of operation.

- Federal Trade Commission Rule
- Marketing Plan
- Community of Interest
Substantial Control

FTC Rule

FTC Compliance Guide:

“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.”
Control Under FTC Rule:

FTC’s Compliance Guide - Significant Control

(1) site approval;
(2) site design or appearance requirements;
(3) hours of operation;
(4) production techniques;
Control Under FTC Rule:

(5) accounting practices;
(6) personnel policies;
(7) promotional campaigns;
(8) restrictions on customers; and
(9) locale or area of operation.
Substantial Control

Significant Assistance:

(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 networks and a website; and
(6) operating manuals.
Substantial Control

No Significant Assistance:

(1) promotional activities intended to help sales;
(2) imposition of health or safety restrictions required by law;
(3) aiding distributors in obtaining financing; or
(4) trademark controls designed to protect trademark owner’s ownership rights.
Replacing the FTC Requirement

14 states replace “substantial control” with marketing plan:

- California
- Connecticut
- Georgia
- Illinois
- Indiana
- Iowa
- Maryland
- Michigan
- New York
- North Dakota
- Oregon
- Rhode Island
- Virginia
- Washington
Definition:

Most widely used definition:

“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.”
Statutory Definition:

Illinois, Iowa, Rhode Island & Washington define “marketing plan” as:

1. prescribing or limiting resale prices;
2. restrictions on use of advertising;
3. giving detailed directions, advice concerning operating techniques;
(4) assigning an exclusive territory;
(5) providing uniformity 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) providing operations manual; and
(12) providing trade secrets.
Iowa, Rhode Island & Washington:

Statutory definition includes one or more of the following:

1. price specifications, special pricing systems or discount plans;
2. sales or merchandising equipment/devices;
3. sales techniques;
4. promotional / advertising materials;
5. training regarding promotions, operations, or management; or
6. operational, managerial, technical, or financial assistance.
Virginia, Oregon, North Dakota, Michigan & Indiana:

- Some states do not provide a statutory definition for marketing term.
- Courts determine the qualifying activities.
What Constitutes a Marketing Plan?

- The “marketing plan” element is fact sensitive.
- Courts generally interpret franchise statutes broadly to ensure protection.
Aristacar Corp. v. Attorney General, (N.Y. 1989)
Supplying radio equipment, customers, and billing services, and dictating dress code, and the type of car to be driven, qualifies as marketing plan.

Boat & Motor Mart v. Sea Ray Boats, Inc., (9th Cir. 1987)
Providing sales directions and sales requirements qualifies as marketing plan.
Sorisio v. Lenox, (D. Conn. 1988)
Training, display of products, and product promotion did not constitute marketing plan when the alleged franchisee carried brands other than the franchisor’s brands.

No marketing plan existed when Whirlpool provided products to be sold and supplied standard policies and procedures because distributor was expected to create its own marketing processes, train its employees, and control its day-to-day operations.
Kennedy v. Lomei, (N.Y. 1991)
No marketing plan existed because the wholesaler did not control the bakery’s sales activities and only fifty percent of products sold were provided by the wholesaler.

No marketing plan because manufacturer did not control pricing, did not assist with inventory, and was not involved in hiring or firing.

Lack of control over advertising, pricing, and products indicated no marketing plan.
Replacing the FTC Requirement

8 states replace “substantial control” with a community interest:

- Hawaii
- Minnesota
- Mississippi
- Missouri
- Nebraska
- New Jersey
- South Dakota
- Wisconsin
Two Factor Test:

Community of interest may exist when:

(1) large portion of an alleged dealer’s revenues are derived from the dealership; and
(2) alleged dealer has made sizeable investments in grantor’s goods or services that are not fully recoverable upon termination.
Four Factor Test:

Courts will consider:

(1) franchisor’s control over the alleged franchisee;
(2) franchisee’s economic dependence on the franchisor;
(3) disparity in bargaining power; and
(4) presence of a franchise specific investment by franchisee.
Multi-Factor Test:

Courts may consider:

1. whether parties have a continuing financial interest in business relationship;
2. level of interdependence of the relationship;
3. length of history between the parties;
4. extent and nature of obligations imposed on parties in the agreement;
5. % of time or revenue devoted by dealer to grantor’s products or services;
6. % of proceeds or profits dealer derives from grantor’s products or services;
Community of Interest

(7) extent and nature of grantor’s grant of territory to dealer;
(8) extent and nature of dealer’s uses of grantor’s trademarks or logos;
(9) extent and nature of dealer’s financial investment in inventory, facilities, and goodwill of dealership;
(10) personnel that 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.
Benefit Test:

Benefit test looks at whether one or the other party “benefitted” from certain aspects of the relationship.
The parties’ label for a relationship may or may not persuade the court to find the relationship to be a franchise.

*Shah v. Racetrac Petroleum Co.*, (6th Cir. 2003)
Finding a franchise existed even though parties referred to their relationship as a lease and specifically stated no franchise relationship.
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.
Thank You!

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