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Trademark Licensors Beware: Is Your License or Distribution Agreement Really a Franchise?

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Summary

- Every franchise is a trademark license, but not every trademark license is a franchise.
- The consequences of violating franchise laws are significant and may result in personal liability of the franchisor's management.
- Franchise status is determined by examining the parties' relationship for a grant of trademark rights, significant business assistance or control, and payment of a required franchise fee.

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In 2010, *Landslide*® magazine published an earlier version of this article explaining when a trademark license or distribution agreement is really a franchise and why franchise status matters. [1] Fourteen years later, there remains widespread confusion among practitioners and brand owners about what distinguishes a nonfranchise license from a franchise. Brand owners continue to claim they had no idea they were engaged in franchising when

they authorized others to use their trademarks and business concepts, nor did their lawyer (if they used one) mention the possibility of franchise laws getting in the way.

Misinformation about licensing also abounds. Recently, an article in *Entrepreneur* magazine touted licensing as a "lucrative alternative" to franchising for expanding a business, recommending that a business owner could reliably license its logo and name to another without crossing into franchisor territory if it offered the licensee something less than a "turnkey business." [2] *Entrepreneur* magazine's advice heedlessly oversimplifies what experienced franchise attorneys know is the "risky exercise" of sorting franchises from nonfranchise licenses. [3]

The last 14 years have seen a proliferation of accidental franchise cases, some involving well-known consumer brands. This is a testament to the low bar that qualifies licenses as franchises and the commanding influence brands have on consumer purchasing decisions. While not all recent accidental franchise cases resulted in a franchise finding, some took years and a substantial investment of time and money for the brand owner to finally defeat the franchise status allegation. Franchise status is a mixed question of fact and law backed by a strong public policy directing fact finders to construe franchise statutes broadly to protect franchisee investments. [4] Because franchise status is such a fact-specific inquiry, accidental franchise cases resist pretrial dismissal, which significantly adds to their nuisance value. [5]

This article explains why franchise status matters and the subtle and sometimes indiscernible differences between a nonfranchise trademark license and a franchise. It highlights recent developments in how courts interpret franchise laws that bear on strategies for structuring licenses to avoid inadvertently creating a franchise.

Why Franchise Status Matters

From a regulatory viewpoint, franchise and nonfranchise licenses are as different as day and night. Nonfranchise licenses are unregulated private consensual arrangements. Franchises, by contrast, are highly regulated. [6]

Franchise sellers have to obey elaborate federal and state presale disclosure and registration laws; nonfranchise licensors do not. Among other things, franchise sales laws require franchisors to disclose their financial statements publicly and make it unlawful for franchisors to answer a prospective franchisee's most urgent question—*How much can I make?*—without complying with complicated disclosure rules. More than a third of all states have relationship laws that dictate substantive terms like venue and choice of law and restrict the conditions under which a franchise may be canceled, terminated, or not renewed. State relationship laws supersede the parties' contract. A terminable-at-will contract clause will not be enforced in a jurisdiction that requires good cause to terminate a franchise agreement, even if the franchisee's attorney actively negotiated the franchise agreement. Some state relationship laws protect a franchisee's right to sell their business, forbid franchisors from discriminating among similarly situated franchisees, and prohibit franchisors from substantially changing the competitive circumstances of a franchise program without good cause. A franchisee may not waive these statutory protections even if it wants to trade for other contract concessions.

Franchise law violations carry significant penalties even if the inadvertent franchisor never knew about the law or had no intent to violate it. Not only is it a felony to sell a franchise without complying with a franchise sales law, but federal and state franchise agencies have broad powers to punish franchise law violators and may freeze assets, order restitution, issue cease and desist orders, ban violators from selling franchises, and recover substantial penalties. [7]

Franchisees have private remedies for state franchise law violations. [8] Besides compensatory damages and, in some states, attorney fees, an injured franchisee may (1) rescind a franchise agreement for disclosure and

registration violations, including fraud in connection with a franchise sale; (2) obtain an injunction to enjoin a wrongful termination or nonrenewal of a franchise; or (3) recover damages or restitution.

Furthermore, state franchise laws impose personal and joint and several liability on the franchisor's management and owners even when the franchisor is a legal entity. [9] Finally, lawyers who overlook franchise laws may be guilty of malpractice and potentially liable to victims of their client's wrongdoing. [10]

Trademark Licenses vs. Franchises

Numerous judicial decisions reveal brand owners in diverse businesses, many of which are sophisticated companies, surprised to be on the receiving end of a lawsuit accusing them of violating a franchise law by entering into or terminating a commercial arrangement with an express or implied trademark license allowing the plaintiff to associate its own business with the defendant's brand.

Following are some new examples since 2010 [11] :

- After acquiring Sun Microsystems, Oracle, the world's largest database management company, terminated a Sun software products reseller without good cause as expressly permitted by the parties' reseller agreement and was sued for wrongful termination under New Jersey's franchise law. Oracle lost a motion for summary judgment because the court could not conclude as a matter of law that the reseller arrangement was not a franchise. [12]

- The City of Madison, Wisconsin, violated the same Wisconsin Fair Dealership Law that nailed the Girl Scouts organization in 2008 when the city refused to renew the contracts of golf pros working at municipal courses without evidence of the golf pros' breach of contract. [13]

- Rental companies Avis and U-Haul and car manufacturer Isuzu were each sued by their dealers for wrongful termination without good cause under different state general franchise laws (not motor vehicle–specific laws). It took each defendant years and numerous appeals ultimately to defeat the franchise status allegations. [14]

- Atlas Van Lines lost a motion for summary judgment seeking to toss a local moving company's wrongful termination claim under New Jersey's franchise law after Atlas terminated the agency agreement without good cause as expressly permitted by the parties' contract. The court refused to reject franchise status as a matter of law. [15]

- A Harley-Davidson dealer that had exclusively represented the brand for nearly 50 years and was authorized by a separate license agreement to produce and sell Harley Davidson logo merchandise successfully stated a claim against Harley Davidson for violation of Hawaii's franchise law after Harley Davidson refused to renew the license agreement and allegedly imposed unreasonable and arbitrary standards of conduct on the dealer. [16]

- Bakery route drivers have sued their suppliers for violating franchise laws to prevent changes to route assignments. It took years of tangling in court and numerous appeals for the suppliers ultimately to defeat the franchise claims. [17]

- Exemplifying the diversity of businesses snared by franchise laws, a cryotherapy chambers distribution agreement, [18] a consulting agreement with a male medical clinic, [19] and contracts between a supplier

and a CBD products retail store could each be franchises under different state franchise laws. [20]

- Illustrating the archetype accidental franchise, a contract allowing a party to operate a restaurant under a licensor's trade name and business concept in exchange for a licensing fee could be a franchise under California's franchise sales and relationship laws, rebuffing the licensor's motion to dismiss the franchise claims on the pleadings. [21]

These decisions involve different, but typical, distribution and licensing arrangements for the offer, sale, or delivery of branded goods or services identified by the seller's trademark. In none of these cases did the parties intend to form a franchise relationship. Certainly no licensor expected to end up defending franchise allegations.

Manufacturers, suppliers, and other trademark owners overlook a possible franchise connection whenever they enter into relationships with independent third parties to sell their branded products or services. Embedded in these distribution arrangements is a de facto trademark license. While not every trademark license creates a franchise, every franchise contains a trademark license.

Given the prevalence of franchising and the interstate, national, and even international scope of so many franchise networks today, attorneys need to know about potentially applicable federal, state, and foreign franchise laws. [22]

Sorting franchises from nonfranchise licenses can be a highly uncertain process. The quality controls that trademark owners *must* retain over a licensee's trademark use closely resemble the marketing controls that are characteristic of a franchise. Given the significant regulatory complications that franchise status carries, it is essential that practitioners appreciate the qualities and characteristics that make an ordinary trademark license a franchise.

What Is a Franchise?

Most people think they know a franchise when they see one. In fact, franchising is a method of distribution, not a particular industry, as evident from the diverse array of accidental franchise cases. There is no uniform definition of a franchise. As consumer protection statutes, courts give franchise laws a sweeping scope. Consequently, a broad variety of unsuspecting business arrangements may qualify as franchises.

At the most basic level, a franchise is defined by the coexistence of three elements:

1. A grant of rights to use another's trademark to offer, sell, or distribute goods or services (the "grant" or "trademark" element)
2. Significant assistance to, or control over, the grantee's business, which may take the form of a prescribed marketing plan or what some jurisdictions more broadly describe as a "community of interest" (the "marketing plan variation" element)
3. Payment of a required fee (the "franchise fee" element)

A franchise finding hinges entirely on whether an arrangement fits the applicable statutory definition. The prototypical definition of a franchise is like a three-legged stool. If any one leg is missing, the relationship is not a franchise, no matter how much proof there is of the other two definitional legs of the stool.

The legal analysis into whether a commercial arrangement is a franchise considers the parties' actual practices, oral as well as written promises, and course-of-dealing evidence. [23] A party cannot avoid a franchise relationship

simply by disclaiming its existence. [24] What the parties call themselves is immaterial. A license, dealership, distributorship, or marketing affiliation agreement is no less a franchise because the parties' contract never uses the "f" word.

While federal and state jurisdictions that regulate franchises share common definitional approaches, each jurisdiction has its own definitional subtleties and mix of exclusions and exemptions. What qualifies as a franchise under the federal franchise sales law may not qualify under state law definitions, or vice versa. What is a franchise in one state may not be a franchise in all the regulating states in which the franchisor operates.

Business owners and their advisers are not the only ones confused. Irreconcilable legal precedents reflect misperceptions among regulators and the judiciary about the legal concept of a franchise. As a result, legislators, regulators, judges, and practitioners alike all suffer from uncertainty about the exact kinds of arrangements intended to be regulated as franchises. [25]

In advising companies that manufacture and distribute products or services or that license business methods, technology, patents, or trademarks to independent operators, practitioners should, as a preliminary matter, consider the possibility of unwittingly creating a franchise. In so doing, they should consult the franchise statutes, judicial opinions, and administrative guides of each jurisdiction in which the parties reside or intend to do business before their client offers an opportunity involving an express or implied trademark license or takes steps to modify or end the relationship.

On the federal level, franchises are governed by a Federal Trade Commission (FTC) rule, which describes both business format and product franchises. [26] Both variations involve the presence of the three basic elements. The business format franchisee adopts the franchisor's business format and identifies its independent operation by the franchisor's trademarks, in exchange for which the franchisee pays the franchisor a fee. The franchisee's operating methods are subject to significant control by the franchisor or, alternatively, the franchisor renders significant assistance to the franchisee in day-to-day operations. Fast food, convenience stores, and real estate services are examples of business format franchises. The product franchisee distributes goods identified by the franchisor's brand manufactured by or for the franchisor. The franchisee pays a fee for the distribution rights above the wholesale price of the goods. As with business format franchises, the franchisor exercises significant control over, or provides significant assistance to, the franchisee. Automobile and gasoline dealerships and delivery route distributors are examples of product franchises.

State law franchise definitions largely resemble the FTC's business format and product franchise definitions in that most also require the combination of the three basic elements. [27] The trademark and fee elements are fundamentally the same as the federal franchise sales law. However, state laws differ by requiring either (1) substantial assistance or control (the federal standard), (2) a marketing plan prescribed in substantial part by the franchisor, or (3) a community of interest. A few state laws define a franchise by a two-prong test that omits payment of a required fee. [28]

The Trademark Element

The grant of rights to associate with another's trademarks in offering, selling, or distributing goods or services is not only a common element of every franchise definition but also the easiest of the three definitional elements to meet. Absent an express prohibition against use of the licensor's trademark, a right to use the mark will be inferred even if the mark is, in fact, never used. [29] For this reason, every franchise involves an express or implied trademark license of some sort.

Franchise definitions vary from requiring a "license to use" the licensor's mark to requiring a "substantial association" between the grantee's business and the licensor's trademark. Under the "license to use" approach, an express contract authorizing trademark use will support a franchise relationship even if the mark is not part of the licensee's trade name—for example, "Smith's Appliances, an authorized Brand X Service Center." Permission to display a manufacturer's logo in dealing with customers satisfies this element. Even without explicit contract authority, long-standing use of a licensor's trademark in dealing with customers may be enough to establish a trademark license.

Courts have found a requisite de facto trademark license in the following situations:

- A distributor sold uniquely configured branded goods that consumers readily associated with a particular manufacturer in an exclusive territory. [30]
- A dealer was entitled to identify itself as an authorized dealer of the manufacturer's products in Yellow Pages advertising. [31]
- A distribution agreement imposed a duty to use best efforts to promote the sale of branded products. [32]
- A distributor was required to wear uniforms and add the licensor's logo or name on delivery vehicles or store windows. [33]

States following the "substantial association" approach have also found the requisite trademark element satisfied when branded products or services account for a significant percentage of an independent operator's overall sales, even though courts vary in how much or little qualifies as "substantial." [34]

Many courts have shown a willingness to stretch the definitional elements to achieve desired results. In one California appellate decision, a substantial association with the licensor's mark was found even though the licensee was forbidden to use the licensor's brand name and, in fact, never used it. [35] The court was swayed by evidence showing that a building owner had relied on the licensor's brand name in renting space to the licensee to operate a cafeteria in the building, which was enough to satisfy the substantial association test.

The licensor's dilemma. The fact that an agreement lacks an express trademark license does not prove the trademark element is missing. A de facto license is part of the rights granted to an independent dealer or distributor who is authorized to sell branded products or services accounting for more than an insignificant percentage of the licensee's overall sales. Since the trademark element's presence may depend on the extent of actual branded sales, contract drafting may not save a license from being a franchise. A contract that expressly denies a trademark license may leave the licensor, manufacturer, or supplier with the worst of both worlds: an agreement that is subject to various franchise laws but lacks the protections that a well-drafted trademark license should contain. While some case law suggests that licensors of branded merchandise may avoid the trademark element by expressly disclaiming any duty to refer customers to the licensee, this drafting approach will not work for manufacturers, suppliers, and licensors that view lead generation services or other types of marketing support as vital to their distribution strategy. [36]

The Marketing Plan Variation Element

A handful of states follow the federal franchise sales law's approach and require the licensor to furnish significant assistance or impose significant controls over the licensee's entire method of operation. The same facts indicating significant assistance or control also identify a marketing plan. Significant assistance exists when the licensor

provides formal sales, repair, or business training programs; site location assistance; management, marketing, or personnel advice; promotional support requiring the licensee's participation or financial contribution; or operating advice such as by furnishing a detailed operating manual. Significant controls exist if the licensor approves or restricts the business location or sales territory, specifies design or appearance requirements, prescribes operating hours, establishes production methods or standards, restricts the customers a licensee may serve, mandates personnel policies or practices, or dictates mandatory accounting practices. Under certain circumstances, any one of these factors may be enough to constitute significant control or assistance. Significant promises of assistance, even if unfulfilled, will satisfy this element. [37] Providing point-of-sale advertising and media support may be enough. [38]

The franchisee's reliance on the franchisor's experience influences whether the licensor's control or assistance is significant. The franchisee's general business experience, knowledge of the industry, and relative financial risk in light of its total business holdings, as well as the extent to which the controls or assistance go beyond normal industry practices, each bear on the reliance factor.

A number of states define a franchise as a trademark license in conjunction with a marketing plan. The marketing plan element is composed of four distinct components, all of which must coexist: (1) a marketing plan (2) prescribed (3) in substantial part (4) by the licensor. Each component has been separately analyzed by judicial and administrative authorities. [39]

Determining if a marketing plan exists is inherently subjective and, consequently, difficult to dodge in a written agreement. While judged by the presence of various facts, no interpretative or judicial opinion suggests a minimum number or combination of facts that inherently guarantee a marketing plan's presence. The parties' contract, course of dealing, and industry customs are all relevant. The term "prescribed" has been interpreted to mean something less than mandatory. Consequently, a marketing plan may be prescribed by implication when it is outlined, suggested, recommended, or otherwise originated by the licensor, even when use of the plan is not obligatory. [40]

Courts differ in the degree of franchisor involvement in a franchisee's daily business activities that is necessary to support a marketing plan. Some require significant control, such as confining sales to assigned territories, imposing sales quotas, establishing mandatory sales training, or supplying detailed instructions for customer selection and solicitation. Other courts have found a marketing plan based on far less—for example, a promoter's recommendations, advice, or suggestions, even when there is no obligation on the franchisee's part to observe them, such as suggesting resale prices and discounts, providing demonstration equipment or advertising materials, recommending or screening advertising materials, or providing product catalogs.

What courts identify as a "marketing plan prescribed in substantial part" may actually be basic to most distributorships. [41] For example, a marketing plan was found to exist when:

- Dealers were required to advertise the manufacturer's products intensively, conduct a variety of promotions, and carry the manufacturer's array of accessory sales devices. [42]
- Distributors marketed products pursuant to a comprehensive advertising and promotional program developed by the supplier, who reserved the right to screen and approve all promotional materials used by the distributors. [43]
- Distributors were required to perform warranty services in accordance with the manufacturer's warranty policy, send representatives to sales meetings, complete the manufacturer's factory service training

program, maintain minimum inventory levels, hire an extra salesperson, and provide periodic sales reports to the manufacturer. [44]

- A promoter promised to provide a marketing plan even though it failed to deliver on its promise. [45]

Administrative and judicial opinions try to forge a distinction between production-type controls, which do not result in a marketing plan, and marketing controls, which do, but the distinction between the two has never been well articulated. [46] A marketing plan can exist even when the controls or advice do not relate to advertising or marketing matters, such as when a manufacturer provides detailed instructions and advice regarding operating techniques and skill training that make independent businesses appear as if they are centrally managed and follow uniform standards.

Several states follow the community of interest model rather than the marketing plan or assistance/control approach but differ in how they define this element. However, all these states agree that a community of interest exists when parties derive fees from a common source—a standard that potentially encompasses every distributorship and license. [47]

The licensor's dilemma. Because the trademark element of a franchise is so easily established, trademark licensors may be tempted to avoid a franchise finding by eliminating the second definitional element—some form of assistance to or control over the licensee's business. This creates a dilemma because the federal trademark law, the Lanham Act, imposes an affirmative duty on licensors to control the quality and uniformity of goods and services associated with their federally registered trademarks. Failure to do so may result in abandonment of trademark rights. As a practical matter, it is often impossible to distinguish trademark quality controls from the factors identifying substantial control, a marketing plan, or a community of interest. It may also be inadvisable to try to avoid franchise laws by eliminating or modifying contractual provisions designed to protect product or service quality or set operating standards that identify the licensee with a larger branded network. A licensor that eliminates or reduces quality controls may not only sacrifice important core values vital to the business and brand but also risk abandoning its trademark rights.

The Required Fee Element

The required fee element captures all sources of revenue paid by a franchisee to a franchisor for the distribution rights or license. The element is deliberately expansive, encompassing lump sum, installment, fixed, fluctuating, up-front, and periodic payments for goods or services, however denominated, whether direct, indirect, hidden, or refundable. [48]

Under federal law, imputation of a franchise relationship can be avoided by deferring required payments over $735 for at least six months after the licensee or distributor begins operations. The federal franchise definition requires the franchisee to make a minimum payment of at least $735 within that time frame. [49] A license will not be deemed a franchise under federal law even if the licensee signs a non-negotiable, secured promissory note (with no acceleration clause) promising to pay the licensor $735 or more after six months. While this exemption offers interesting structuring opportunities for franchises sold in states without franchise laws, it has no counterpart in most states with franchise laws. Deferral of fees, therefore, is not a universal solution for avoiding franchise status.

All jurisdictions exclude payments that do not exceed the bona fide wholesale price of inventory if there is no accompanying obligation to purchase excessive quantities. [50] To qualify, the payment must be for goods for

which there is a ready market. [51] Most product distribution arrangements rely on the bona fide wholesale price exclusion in structuring nonfranchise distributorship or dealership programs.

For the fee element, only required payments count, not optional ones. Nevertheless, calling something optional is not necessarily controlling. Payments, though nominally optional, may be deemed required if they are essential for the successful operation of the business. [52]

Finally, to be classified as a required fee, the payment must be made to the licensor or its affiliate or for their benefit as the quid pro quo for the licensing or distribution rights. [53] For this reason, a franchisee's payments to third parties to get its business up and running are not franchise fees. [54] Likewise, commissions paid by a licensor to a licensee are not franchise fees because no money flows from the licensee to the licensor. [55] If, by arrangement, a licensee is required to discharge the licensor's debt to a third party, or a third party remits a portion of the licensee's payments to the licensor, an indirect franchise fee exists. [56]

There remains considerable confusion about whether and when ordinary business expenses paid to a licensor are franchise fees and not for the licensing or distribution rights. Reported decisions offer little practical guidance for distinguishing payments for ordinary business expenses from unrecoverable investments made for the right to do business. [57] One case suggests that payments to a licensor in exchange for services that are customarily used by others in the same business line may be fairly categorized as ordinary business expenses. [58] Another court explained the distinction this way: "[I]f [the dealer] would have incurred some or all of the same communications system expense regardless of the nature of its agreement with the manufacturer, then it is difficult to see how the expense was one incurred for the right to do business with [the manufacturer]." [59]

There is no bright-line rule for distinguishing when payments to a licensor are ordinary business expenses and not for the right to use the licensor's marks. For example, historically, advertising fees paid to a licensor have commonly been classified as franchise fees. [60] However, a decision under the Minnesota Franchise Act found advertising fees paid to a supplier to be ordinary business expenses where (1) the fees were not based on the retailer's gross or net sales, but on the amount of inventory purchased from the supplier; (2) the supplier derived no income or profit from the advertising fees and supposedly took nothing out of the advertising fund to cover its administrative costs, and (3) the supplier kept the fees in a segregated account and did not commingle them with its own operating revenues. [61] Co-op advertising fees common to beverage and other distribution programs—where the supplier matches the distributor's contribution and spends the funds entirely to promote the brand—have also been found to be ordinary business expenses when the distributor is free to opt out of participating in the supplier's marketing programs. [62]

At the same time, payments to a licensor for equipment and other items that the licensor permits the licensee to buy from other sources are not franchise fees simply because the licensee chooses to buy the items from the licensor and not shop elsewhere. [63]

While a franchise fee—direct or indirect—is generally a prerequisite for application of federal and state franchise *sales* laws, it is not a prerequisite for the application of several *relationship* laws regulating termination, nonrenewal, and other substantive conditions of the parties' relationship. [64] As noted, a handful of state franchise and dealer relationship laws regulate arrangements defined by a two-prong test that omits the required fee element.

The licensor's dilemma. For the trademark licensor trying to avoid a de facto franchise agreement, the fee element is the easiest of the three definitional prongs to avoid. A manufacturer or supplier of branded goods that

limits its compensation from a distributorship or dealership to the difference (markup) between its cost of goods and the bona fide wholesale price at which it sells the goods to distributors or dealers can lawfully avoid the franchise laws in all jurisdictions that use a three-prong definition. This is true regardless of how closely the licensor, manufacturer, or supplier controls the distribution process or how much the supplier's markup is. [65]

Often a trademark owner is in a position to collect a premium from those who want to affiliate with its brand. A manufacturer or supplier may impose innocuous payments for noninventory materials or support services, like sales manuals, demonstration kits, point-of-sale materials, or bookkeeping services, not suspecting that these payments may be enough to constitute a franchise fee.

Some branded affiliations do not involve the purchase of inventory, like service businesses and technology alliances. In these relationships, the bona fide wholesale price exception is not available, and all payments that flow from the licensee to the licensor are potentially franchise fees.

Frequently, licensors, manufacturers, and suppliers do not awake to the reality of the franchise relationship until years after it is formed when they seek to end the relationship pursuant to an at-will termination provision in their contract. Franchise relationship laws prevent the licensor from ending the relationship unless the licensee is in material breach, the essential basis of good cause. Because franchise laws cannot be waived, once a fee is paid anytime during the parties' affiliation, a licensor may find itself foreclosed from reverting to nonfranchise status even if the licensor offers to refund the unintended franchise fee. [66] The dilemma for the trademark licensor is that, in order to escape franchise regulation, it may be required to leave dollars on the table.

Every U.S. jurisdiction regulating franchises has its own mix of definitional exclusions and exemptions, offering a complicated and often confusing maze of structuring opportunities and limitations for companies considering regional or national expansion. Some exclusions and exemptions are common in most jurisdictions, [67] while others are unique to a particular jurisdiction. [68] Accordingly, individual statutes must always be checked. For example, the federal franchise sales law and some, *but not all*, regulating states exclude or exempt arrangements referred to as "fractional franchises" in which less than 20% of the licensee's revenue is derived from sales of the licensed brand. [69]

Why Accidental Franchises Happen

Accidental franchises occur for two basic reasons: (1) franchise laws poorly articulate the distinction between nonfranchise and franchise licenses, and (2) brands drive consumer purchasing decisions. Branding is far more important to consumer purchasing decisions today than it was in the 1970s when franchise laws were first enacted. [70] Many more businesses today catapult their expansion by licensing their name and business concept to others willing to pay money to hitch their star to a better-recognized brand.

Just since 2010, when the prior version of this article was published, new digital technologies and ubiquitous digital connectivity have profoundly changed how brands reach consumers and how consumers experience brands. [71] Browser fingerprints allow brands to find and interact with new audiences, push promotions, and gather detailed purchasing data based on a consumer's search history. [72] Brand marketing today is highly personalized, designed to forge emotional bonds with consumers to amplify their loyalty and repeat business. [73] Companies have all sorts of new technologies at their disposal to measure the quality of a customer's engagement with a brand over multiple digital modalities. [74] Nothing illustrates the colossal impact of these changes better than influencer marketing, a strategy in its infancy when the earlier version of this article was published 14 years

ago. [75] Consumers today, more than ever, buy the brands they know or that are endorsed by people they trust. [76]

Branding's influence on consumer purchasing decisions fuels the rise in accidental franchises. Each time a license, distributorship, strategic trademark alliance, or other type of branded joint venture or marketing affiliation is formed, the cornerstone of a franchise potentially is laid. Every branded distribution arrangement involves an implied, if not an express, trademark license. Strategic affiliations between brand owners, with each owner giving the other the right to affiliate publicly with the other's brand, are, at a minimum, de facto licenses. With few exceptions, the brand owner's equity stake in a joint venture will not save the joint enterprise—a distinct legal entity—from being classified as a franchisee.

Courts have shown no sympathy for trademark owners that defend franchise claims by pleading ignorance of the law or no intent to create a franchise. [77] Modeled after U.S. security laws, franchise statutes impose strict liability, thereby making a defendant's intent or knowledge of the law irrelevant. [78] Franchise laws have their roots in consumer protection legislation and, as a consequence, are construed liberally.

Given the serious consequences flowing from an accidental franchise, lawyers should suspect a franchise whenever an express or de facto trademark license presents itself. Strategic branding alliances, joint ventures, sales agencies, distribution cooperatives, and technology licenses should all be viewed suspiciously as hidden franchises and closely inspected to see if money is being paid, directly or indirectly, by one party for the right to associate with the other's trademarks.

Certain aspects of the franchise definition, like the marketing plan, community of interest, and substantial assistance and control elements, are so inherently imprecise that it is difficult to render an opinion to a client that an arrangement does not contain at least some indicia of a franchise. The key is knowing how many factors are enough to tip the scale.

Counsel should never rely on contract terminology or disclaimers, neither of which will dependably defeat deemed franchise status. Yet contract drafters are not without tools. A license or distribution contract deliberately structured to avoid a franchise definitional element or take advantage of a statutory exemption or exclusion should express these facts in the contract. While self-serving and certainly not bulletproof, the plain language will aid and possibly influence the fact-finder's analysis of the franchise claim.

Structural solutions may save some relationships from the reach of franchise laws but often come at the price of sacrificing essential economic objectives or competitive opportunities. The regulatory burdens of being deemed a franchisor should be kept in perspective. Numerous companies comply with federal and state franchise laws and sustain and grow successful, viable businesses. They compete in the marketplace while complying with presale disclosure and annual registration duties, close franchise sales while honoring rules restricting promises about future earnings, and manage franchise relationships while respecting laws requiring good cause for termination or nonrenewal.

In the long run, the costs associated with franchise avoidance, be they added business risks or extra legal expenses, may be more painful than franchise law compliance. [79] Companies are short-sighted if their overwhelming desire to avoid legal regulation as a franchise drives their business decisions and strategic objectives.

Endnotes

1. Rochelle Spandorf, *Structuring Licenses to Avoid the Inadvertent Franchise*, 2 LANDSLIDE, no. 4, Mar./Apr. 2010, at 37.

2. Emiliano Jöcker, *Franchising Is Not for Everyone. Explore These Lucrative Alternatives to Expand Your Business*, ENTREPRENEUR (Apr. 24, 2024), https://www.entrepreneur.com/franchises/franchising-is-not-for-everyone-explore-these-lucrative/472701.

3. Ann Hurwitz & David W. Oppenheim, *You Don't Want to Be a Franchise? Structuring Business Systems Not to Qualify as Franchises*, *in* A.B.A. 34TH ANNUAL FORUM ON FRANCHISING W-3, at 50 (2011).

4. *See* Thueson v. U-Haul Int'l, Inc., 50 Cal. Rptr. 3d 669, 672, 675 (Ct. App. 2006) (mixed question of fact and law and broad construction).

5. As a mixed question of fact and law, franchise status cases lend themselves to expert witness testimony. *See* Glenn Plattner et al., *Educating Courts: Using Franchise Lawyers and Consultants as Expert Witnesses in Franchise Cases and Avoiding Exclusion of Testimony as "Legal Opinion,"* 42 FRANCHISE L.J. 135 (Fall 2022); Michael L. Sturm & Jeffrey H. Wolf, *Because I Said So: Experiential-Based Opinions in Franchise Cases*, *in* A.B.A. 45TH ANNUAL FORUM ON FRANCHISING W-8 (2022); Rochelle Spandorf, *Attorneys Serving as Expert Witnesses in Franchise Disputes*, L.A. LAW., Oct. 2021, at 12; Rupert M. Barkoff et al., *Using Franchise Attorneys as Expert Witnesses—Not Just for Legal Malpractice Cases Anymore*, *in* A.B.A. 35TH ANNUAL FORUM ON FRANCHISING W-7 (2012).

6. The ABA publication *Fundamentals of Franchising* (4th ed. 2015) is an excellent resource for lawyers new to franchise law on how federal and state franchise laws regulate franchises.

7. In 2022, in the FTC's first major civil enforcement action against a franchisor in over 10 years, the FTC sued quick-service burger restaurant franchisor Burgerim Group USA Inc. and its owner for violating the federal franchise sales law by "using false promises while withholding information required by its Franchise Rule" in selling franchises to more than 1,500 people, each of whom paid Burgerim between $50,000 and $70,000 in franchise fees and most of whom were never able to open their restaurants after Burgerim pocketed their money. In January 2024, a federal district court awarded the FTC over $56,000,000 in damages and penalties and upheld a permanent injunction forbidding the franchisor's owner from ever selling any franchises again. *See Burgerim, U.S. v.*, FED. TRADE COMM'N (Jan. 19, 2024), https://www.ftc.gov/legal-library/browse/cases-proceedings/2023057-burgerim-us-v. The FTC's complaint followed several state enforcement actions that barred the franchisor and its owner from offering and selling franchises in the state.

8. While franchisees have private remedies for state franchise law violations, only the FTC may enforce the federal franchise sales law. However, in states where only the federal franchise sales law applies, an injured franchisee may be able to use a state unfair trade practices law to recover damages for a federal franchise sales law violation. *See generally* Leslie Smith & Ari N. Stern, *Litigating Franchise Cases Under Unfair Trade Practices Statutes*, *in* A.B.A. 40TH ANNUAL FORUM ON FRANCHISING W-6 (2017).

9. *See*, *e.g.*, Dollar Sys., Inc. v. Avcar Leasing Sys., Inc., 890 F.2d 165, 176 (9th Cir. 1989) (a defendant's ignorance of the law is not a defense); Courtney v. Waring, 237 Cal. Rptr. 233, 237 (Ct. App. 1987) (potential for attorney malpractice liability to nonclients).

10. *See* Charles S. Marion & Ari N. Stern, *"But They Were Not My Client": The Prospect of a Franchisor's Outside Counsel Being Liable to an Aggrieved Franchisee*, 41 FRANCHISE L.J. 63 (Summer 2021); Alexander M. Meiklejohn, *UFOCs and Common Law Claims Against Franchise Counsel for Negligence*, 25 FRANCHISE L.J. 45 (Fall 2005).

11. *See* Spandorf, *supra* note 1 (discussing accidental franchise cases involving retailer Gap, business solutions provider Safeguard, the national Girl Scouts organization, and Nationwide Insurance).

12. Oracle Am., Inc. v. Innovative Tech. Distribs. LLC, Nos. 5:11-CV-01043-LHK, 11-CV-02135-LHK, 2012 WL 4122813 (N.D. Cal. Sept. 18, 2012).

13. Benson v. City of Madison, 897 N.W.2d 16 (Wis. 2017).

14. Thueson v. U-Haul Int'l, Inc., 50 Cal. Rptr. 3d 669 (Ct. App. 2006) (California law); Adees Corp. v. Avis Rent A Car Sys., Inc., 157 F. App'x 2 (9th Cir. 2005) (Washington law); JJCO, Inc. v. Isuzu Motors Am., Inc., No. 08-00419 SOM/LEK, 2009 WL 1444103 (D. Haw. May 22, 2009) (Hawaii law).

15. Ocean City Express Co. v. Atlas Van Lines, Inc., 194 F. Supp. 3d 314 (D.N.J. 2016).

16. Cycle City, Ltd. v. Harley-Davidson Motor Co., No. 14-00148 HG-RLP, 2015 WL 3407825 (D. Haw. May 26, 2015).

17. *See* Atchley v. Pepperidge Farm, Inc., No. CV-04-452-EFS, 2012 WL 6057130 (E.D. Wash. Dec. 6, 2012) (Washington law); Petereit v. S.B. Thomas, Inc., 63 F.3d 1169 (2d Cir. 1995) (New York law).

18. Live Cryo, LLC v. CryoUSA Import & Sales, LLC, No. 17-CV-11888, 2017 WL 4098853 (E.D. Mich. Sept. 15, 2017) (Michigan law).

19. Chi. Male Med. Clinic, LLC v. Ultimate Mgmt., Inc., No. EDCV 13-00199 SJO (OPx), 2014 WL 7180549 (C.D. Cal. Dec. 16, 2014) (Illinois law).

20. Sunflora, Inc. v. Nat. Sols., LLC, No. CV 20-01141-CJC(MRWx), 2021 WL 8316392 (C.D. Cal. Dec. 16, 2021) (California law).

21. Good Times Rests., LLC v. Shindig Hosp. Grp., LLC, No. 21-cv-07688-AGT, 2022 WL 16856106 (N.D. Cal. Nov. 10, 2022).

22. Franchise sales in the U.S. are subject to dual regulation at the federal and state levels depending on where the parties reside or do business. The federal franchise sales law regulates franchise sales in all 50 states by imposing presale disclosure duties on franchisors but no type of registration with a federal agency. Fifteen states (California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin) have franchise sales laws that require franchisors to register their disclosure document with a state agency. The federal franchise sales law supplements state franchise sales laws but does not preempt them. More states have some type of relationship law than franchise sales law. Many countries have copied the U.S.'s patchwork system of regulating franchises. The *Fundamentals* book, *supra* note 6, dedicates separate chapters to federal and state disclosure and registration requirements and to international franchising.

23. The federal franchise sales law excludes purely oral agreements from its franchise definition, but all state franchise definitions except South Dakota's apply to both oral and written contracts.

24. People v. Kline, 168 Cal. Rptr. 185 (Ct. App. 1980) (partnership agreement held to be franchise).

25. *See* Paul R. Fransway, *Traversing the Minefield: Recent Developments Relating to Accidental Franchises*, 37 Franchise L.J. 217 (Fall 2017); Stephen C. Root, *The Meaning of "Franchise" Under the California Franchise Investment Law: A Definition in Search of a Concept*, 30 McGeorge L. Rev. 1163, 1188 (1999). Sales agencies and employment arrangements may qualify as franchises. *See* John R.F. Baer et al., *When Are Sales Representatives Also Franchisees?*, 27 Franchise L.J. 151 (Winter 2008); Dean T. Fournaris, *The Inadvertent Employer: Legal and Business Risks of Employment Determinations to Franchise Systems*, 27 Franchise L.J. 224 (Spring 2008).

26. Disclosure Requirements and Prohibitions Concerning Franchising, 72 Fed. Reg. 15444 (Mar. 30, 2007). Originally, the FTC rule applied to a third type of franchise: business opportunity ventures, which are akin to franchises but without the trademark element (e.g., vending machine routes and work-at-home programs). The FTC now regulates business opportunities in a separate rule, 16 C.F.R. pt. 437.

27. Subtle definitional differences can dramatically affect statutory coverage. For example, *Gentis v. Safeguard Business Systems, Inc.*, 71 Cal. Rptr. 2d 122, 123 n.1 (Ct. App. 1998), observed that California's franchise definition, a three-prong definition, expresses the right to offer, sell, *or* distribute goods or services in the disjunctive, making it broader than other three-prong definitions. New York's franchise law requires the combination of just two elements, either a

trademark and a marketing plan or a marketing plan and a franchise fee, making it "terrifyingly" broader than three-prong franchise definitions. *See* Thomas Pitegoff, *The Terrifying New York Definition of a Franchise*, Offit Kurman Blogs (Apr. 6, 2021), https://offitkurman.com/blog/2021/04/06/the-terrifying-new-york-definition-of-a-franchise/.

28. Alaska, Arkansas, Connecticut, Delaware, Missouri, Nebraska, New Jersey, Wisconsin, Puerto Rico, and the U.S. Virgin Islands have relationship laws that define the protected relationship without reference to payment of a required fee. These "two-prong" definitions potentially sweep a much broader array of commercial arrangements than three-prong definitions.

29. The California Department of Corporations, California's franchise agency when the California Franchise Investment Law, the country's first franchise sales law, was enacted in 1971, explained the meaning of California's franchise definition in Release 3-F: When Does an Agreement Constitute a "Franchise" (June 22, 1994), https://dfpi.ca.gov/rules-enforcement/laws-and-regulations/releases-under-investment-and-financial-services-laws/commissioners-release-3-f/ [hereinafter Release 3-F]. Release 3-F has served as an interpretative guidepost influencing courts and franchise agencies in and outside of California. Regarding the trademark grant, Release 3-F says: "[I]f a franchisee is granted the right to use the franchisor's symbol, that part of the franchise definition is satisfied even if the franchisee is not obligated to display the symbol."

30. Lobdell v. Sugar 'N Spice, Inc., 658 P.2d 1267 (Wash. Ct. App. 1983).

31. Am. Bus. Interiors, Inc. v. Haworth, Inc., 798 F.2d 1135 (8th Cir. 1986).

32. Cassidy Podell Lynch, Inc. v. SnyderGeneral Corp., 944 F.2d 1131, 1139 (3d Cir. 1991).

33. Cooper Distrib. Co. v. Amana Refrigeration, Inc., 63 F.3d 262, 272–73 (3d Cir. 1995).

34. *See* Fransway, *supra* note 25, at 220 ("court decisions . . . disagree on what kind of association with a trademark is 'substantial' for purposes of the statutory definition of a franchise"); Daniel J. Oates et al., *Substantial Association with a Trademark: A Trap for the Unwary*, 32 Franchise L.J. 130 (Winter 2013) (summarizing the wide variation across jurisdictions in what qualifies as "substantial association").

35. Kim v. Servosnax, Inc., 13 Cal. Rptr. 2d 422 (Ct. App. 1992).

36. Decisions under California's and Washington's franchise laws have found arrangements with independent delivery service providers not to be franchises based partially on the fact that the independent providers did not cultivate customers on their own but merely fulfilled deliveries for the cartage company. *See* Roberts v. C.R. Eng., Inc., 848 F. Supp. 2d 1087 (N.D. Cal. 2012) (California law); Lads Trucking Co. v. Sears, Roebuck & Co., 666 F. Supp. 1418 (C.D. Cal. 1987) (California law); E. Wind Express, Inc. v. Airborne Freight Corp., 974 P.2d 369 (Wash. Ct. App. 1999) (Washington law). Some licensors attempt to avoid franchise regulation by claiming that they offer certification programs, not franchises. True certification programs involve a "certification mark," a specialized type of trademark that must be licensed to everyone meeting the certification standards. Franchises involve traditional trademark licenses issued selectively by the brand owner. *See* Rochelle B. Spandorf et al., *Certification Programs: Franchises or Not?*, 33 Franchise L.J. 505 (Spring 2014).

37. People v. Kline, 168 Cal. Rptr. 185, 189 (Ct. App. 1980) (franchisor may not "circumvent" California's franchise law by promising a marketing plan but not delivering one).

38. Release 3-F, *supra* note 29 ("[A] sales program may be 'prescribed' by the franchisor where the franchisor supplies the franchisee with sales aids or props, such as demonstration kits, films, or detailed instructions for personal introduction and presentation of the product, possibly including the text of a sales pitch and especially where such a program is supported by training material, courses, or seminars.").

39. *Id.*; *see also* Michael D. Braunstein & Megan B. Center, *A Crash Course on Interpretation of the "Marketing Plan or System" Element of State Franchise Statutes*, 42 Franchise L.J. 173 (Fall 2022).

40. Release 3-F, *supra* note 29 ("A marketing plan or system may be 'prescribed' within the meaning of Section 31005(a), although there may be no obligation on the part of the franchisee to observe it, where a specific sales program is outlined, suggested, recommended, or otherwise originated by the franchisor.").

41. Steven D. Wiener, Gentis v. Safeguard Business Systems, Inc. *Liberal Construction of Remedial Statutes: What Is a Franchise?*, 17 Franchise L.J. 115 (Spring 1998).

42. Boat & Motor Mart v. Sea Ray Boats, Inc., 825 F.2d 1285 (9th Cir. 1987).

43. Meadow Fresh Farms, Inc. v. Sandstrom, 333 N.W.2d 780 (N.D. 1983).

44. Carlos v. Philips Bus. Sys., Inc., 556 F. Supp. 769 (E.D.N.Y. 1983), *aff'd in part and rev'd in part*, 744 F.2d 287 (2d Cir. 1984).

45. People v. Kline, 168 Cal. Rptr. 185 (Ct. App. 1980).

46. Whether know-how controls, common to patent licenses, are enough to turn a nonfranchise license into a franchise depends on whether the know-how affects just an aspect of the licensee's operations (e.g., production) or is more pervasive.

47. For a comprehensive discussion of the "community of interest" definitional element, see Megan B. Center, *Accidental Franchises: It Takes a Community (of Interest)*, 39 Franchise L.J. 545 (Spring 2020).

48. See Sandra Gibbs, *Hidden Franchise Fees: Seeking a Rational Paradigm*, 39 Franchise L.J. 493 (Spring 2020), for a thorough discussion of the franchise fee element in federal and state franchise definitions. In *Best Western International Inc. v. Twin City Lodging LLC*, No. CV-18-03374-PHX-SPL, 2019 WL 3430174, at *4 (D. Ariz. July 30, 2019), an operator of a Best Western hotel pleaded enough facts to support claims for violation of Minnesota's franchise law by citing to the parties' membership agreement, which required the operator to pay Best Western an entrance fee to become a Best Western member.

49. 16 C.F.R. § 436.8(a)(1). The FTC increases the minimum payment threshold every four years based on the Consumer Price Index. Press Release, Fed. Trade Comm'n, FTC Publishes Inflation-Adjusted Monetary Thresholds for Three Exemptions in Franchise Rule (July 12, 2024), https://www.ftc.gov/news-events/news/press-releases/2024/07/ftc-publishes-inflation-adjusted-monetary-thresholds-three-exemptions-franchise-rule. When the rule became effective in 2007, the original minimum payment threshold was $500.

50. For example, in *Rhine Enterprises LLC v. Refresco Beverage US, Inc.*, No. 21-cv-810-DWD, 2022 WL 2439966, at *3 (S.D. Ill. July 5, 2022), a beverage distributor's wrongful termination claim under Illinois's franchise law survived a motion to dismiss when the complaint alleged that the distributor had to purchase excessive quantities of inventory costing more than the $500 statutory threshold for a franchise fee.

51. PW Stoelting, L.L.C. v. Levine, No. 16-C-381, 2018 WL 6603874, at *1 (E.D. Wis. Dec. 17, 2018) (minimum purchase requirement was not an indirect franchise fee where there was no evidence the distributor was stuck with excessive quantities of inventory bought at a bona fide wholesale price). In *Cambria Co., LLC v. M&M Creative Laminants, Inc.*, 995 N.W.2d 426, 436 (Minn. Ct. App. 2023), payments by an installer to a supplier for finished countertops bought for resale to homeowners and other end users were covered by the bona fide wholesale price exception to Minnesota's franchise fee definition even though the price covered the supplier's fabrication services; the court found that the parties' contract primarily involved the purchase of inventory and only incidentally involved services.

52. Release 3-F, *supra* note 29 ("[W]hile a truly optional payment is not a franchise fee, a payment by a franchisee, though nominally optional, may in reality be essential; this is especially so if the franchisor intimates or suggests that the payment is essential for the successful operation of the business."). However, in *Cognex Corp. v. Air Hydro Power, LLC*, 691 F. Supp. 3d 315, 322 (D. Mass. 2023), the court rejected the distributor's argument that its purchase of recommended demonstration equipment from the supplier was a practical necessity that deserved to be treated as a required fee under Florida's and Indiana's franchise laws.

53. In *Louis DeGidio, Inc. v. Industrial Combustion, LLC*, 66 F.4th 707 (8th Cir. 2023), the distributor's payments to the supplier for replacement parts at above bona fide wholesale prices were not a franchise fee under Minnesota's franchise law when the distributor was allowed to and did buy replacement parts from the original manufacturer as well. The Eighth Circuit reasoned, "For sales at a higher price to constitute a franchise fee, there must be evidence of compulsion accompanied by the threat of termination." *Id.* at 713. There was no evidence the supplier had threatened to terminate the distribution agreement if the distributor bought parts from another source.

54. *See* Quick Dispense, Inc. v. Vitality Foodservice, Inc., No. 8:23-cv-02322-FWS-ADS, 2024 WL 655996, at *7 (C.D. Cal. Feb. 2, 2024) ("[I]n determining whether a franchise fee has been paid, courts must draw a distinction between ordinary business expenses and unrecoverable investments made for the right to do business."); Bennion & Deville Fine Homes, Inc. v. Windermere Real Estate Servs. Co., No. CV 15-1921 R, 2016 WL 11185300, at *3 (C.D. Cal. Oct. 20, 2016) (travel and related expenses paid to third parties to send employees to training and payments to third parties for advertising were ordinary business expenses, not franchise fees).

55. *See* Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures; Promulgation of Final Interpretive Guides, 44 Fed. Reg. 49966, 49967–68 (Aug. 24, 1979) ("Agency relationships in which independent agents, compensated by commission, sell goods or services (*e.g.* insurance salespersons) are excluded, since there is no 'required payment.'"); Adees Corp. v. Avis Rent-A-Car Sys., Inc., No. CV 02-6363-GHK(RCx), 2003 U.S. Dist. LEXIS 26293 (C.D. Cal. Nov. 19, 2003); Adees Corp. v. Avis Rent A Car Sys., Inc., 157 F. App'x 2 (9th Cir. 2005) (explaining the rationale for why subtractions from a commission are not an indirect franchise fee). *Thueson v. U-Haul International, Inc.*, 50 Cal. Rptr. 3d 669 (Ct. App. 2006), the first California state court decision to explain what constitutes a franchise fee under California's franchise law, is a commission deduction case. The U-Haul dealer made no payments to U-Haul; instead, U-Haul deducted expenses for the dealer's use of a local telephone line, directory listing, and local computer terminal from the dealer's rental commissions. *Thueson* rejected the argument that the commission deductions were indirect franchise fees because the subtractions were taken off of the gross commission and the parties' contract entitled the dealer to a net commission.

56. Release 3-F, *supra* note 29 ("Payments which the franchisee is required to make under the franchise agreement for the account of the franchisor are equivalent to payments made to the franchisor.").

57. *See* Gibbs, *supra* note 48, at 501–08 (reviewing various theories that courts have used to distinguish franchise fees from payments to a franchisor found to be ordinary business expenses); *see also* Macedonia Distrib., Inc. v. S-L Distrib. Co., LLC, No. SACV 17-1692 JVS (KESx), 2018 WL 6190592, at *6 (C.D. Cal. Aug. 7, 2018) ("the critical inquiry" as to whether something is a franchise fee and not an ordinary business expense "is whether Macedonia placed its own funds at risk in exchange for entering into its business relationship with S-L given that such firm-specific investments can create an inequality of bargaining power"). *Thueson* followed *Wright-Moore Corp. v. Ricoh Corp.*, 908 F.2d 128 (7th Cir. 1990), which interpreted the franchise fee definition in Indiana's franchise law and was the first court to enunciate an often-quoted concept that a franchise fee is a "firm-specific investment in the franchisor," not a payment for ordinary business expenses. Unfortunately, neither *Thueson* nor *Wright-Moore* shed any light on when a payment to a licensor is or is not a firm-specific investment. Furthermore, *Thueson*'s discussion of the "firm-specific investment" concept was dicta as *Thueson* was a commission deduction case.

58. *See* Wave Form Sys., Inc. v. AMS Sales Corp., 73 F. Supp. 3d 1052, 1062 (D. Minn. 2014) (payments to a franchisor for goods or services typically bought by others in the same line of business support the payments' reasonable business purpose, which indicates the payments are an ordinary business expense, not a franchise fee).

59. JJCO, Inc. v. Isuzu Motors Am., Inc., No. 08-00419 SOM/LEK, 2009 WL 1444103, at *8 (D. Haw. May 22, 2009).

60. Release 3-F, *supra* note 29 (citing commissioner opinions issued shortly after the California law was enacted finding advertising fees to be franchise fees). In *Bly & Sons, Inc. v. Ethan Allen Interiors, Inc.*, No. 05-668-GPM, 2006 WL 2547202 (S.D. Ill. Sept. 1, 2006), an Illinois federal district court found that a mandatory contribution of 2% of a licensee's invoices to an advertising fund administered by Ethan Allen was a franchise fee under the Illinois franchise law and, as a result, the Illinois "good cause" statute applied to the parties. "It is one thing, as Defendants suggest, for Plaintiff to incur some advertising expenses as an ordinary business expense; it is another for Ethan Allen to require its dealers to pay a percentage of their invoices into a common advertising fund." *Id.* at *3.

61. *See* R&A Small Engine, Inc. v. Midwest Stihl, Inc., No. 06-877(DSD/JJG), 2006 U.S. Dist. LEXIS 92208 (D. Minn. Dec. 20, 2006). Cases interpreting Minnesota's franchise fee definitional element may be outliers compared to other jurisdictions. *See* 20A2 Minn. Prac., Business Law Deskbook § 21:53 (Dec. 2023) (comparing California law).

62. *Day Distributing Co. v. Nantucket Allserve, Inc.*, No. 07-CV-1132 (PJS/RLE), 2008 U.S. Dist. LEXIS 57334 (D. Minn. July 25, 2008) (Minnesota law), relied on the *Midwest Stihl* decision cited in the previous note. In turn, *JJCO*, 2009 WL 1444103, relied on *Day Distributing*. *JJCO* ruled that marketing fees that an Isuzu dealer was required to pay to cover its share of Isuzu's advertising costs were ordinary business expenses, not a franchise fee. *JJCO* failed to note that the marketing program in *Day Distributing* was optional as there was evidence that the distributor had opted in and out of participating, which proved that the distributor's marketing fee payments were not required and on this basis were not franchise fees.

63. *See, e.g.*, Ill. Admin. Code tit. 14, § 200.105 (excluding payments for items that the franchisor permits the franchisee to buy from third parties and that are readily available elsewhere); Hamade v. Sunoco, Inc., 721 N.W.2d 233, 246 (Mich. Ct. App. 2006) (franchise fee requires a transfer of wealth; loan repayment was not a franchise fee absent proof of above-market interest rate).

64. *See supra* note 28.

65. Sports Racing Servs., Inc. v. Sports Car Club of Am., Inc., 131 F.3d 874, 891 (10th Cir. 1997) (Indiana law). Whether a markup above a bona fide wholesale price is an indirect franchise fee requires a fact-specific inquiry. *See* Coyne's & Co. v. Enesco, LLC, 553 F.3d 1128, 1132 (8th Cir. 2009) (35–50% markup over manufacturer's cost of goods was not an indirect franchise fee under Minnesota franchise law); Kenaya Wireless, Inc. v. SSMJ, L.L.C., No. 281649, 2009 Mich. App. LEXIS 692 (Mar. 24, 2009) (markup to cover supplier's shipping and overhead costs did not prevent bona fide wholesale price finding).

66. A franchise fee includes payments for the right to enter a business that are made during the course of the business, not just at the inception of the parties' relationship. In *To-Am Equipment Co. v. Mitsubishi Caterpillar Forklift America, Inc.*, 152 F.3d 658, 659–60 (7th Cir. 1998), the Seventh Circuit found that a tractor dealership, which was not a franchise at the inception of the parties' relationship, became one when the dealer's incremental payments for sales manuals over the course of eight years exceeded $500, Illinois's statutory threshold. The idea that a nonfranchise relationship can morph into a franchise sometime after the parties execute a contract adds uncertainty to the status of licensing and distribution arrangements.

67. For example, transfers by franchisees are not regulated by federal or state franchise sales laws if the buyer assumes the seller's license agreement and the licensor's involvement is confined to approving the buyer's qualifications.

68. For example, Minnesota exempts burglar alarm franchises and arrangements between local and national airline carriers.

69. Leonard D. Vines et al., *Fractional Franchise Exemption: Friend or Foe?*, 30 Franchise L.J. 72, 85 (Fall 2010) (providing an in-depth analysis of the subtle variations across jurisdictions offering a fractional franchise exemption).

70. Marc de Swaan Arons, *How Brands Were Born: A Brief History of Modern Marketing*, Atlantic (Oct. 3, 2011), https://www.theatlantic.com/business/archive/2011/10/how-brands-were-born-a-brief-history-of-modern-marketing/246012/ (tracing the role of brands in consumer decision-making from the "Mad Men" era of the 1960s to modern marketing practices at the time of the article's publication).

71. *See* Mary Kearl, *The Impact of Digital Transformation on Customer Experience*, Medallia (Jan. 26, 2024), https://www.medallia.com/blog/digital-transformation-customer-experience-impact/ (reflecting on the last decade's digital technology revolution that has altered how brands find and interact with their customers).

72. Anna Margulis et al., *Connecting with Consumers Using Ubiquitous Technology: A New Model to Forecast Consumer Reaction*, 121 J. Bus. Rsch. 448 (2020).

73. *See* Justin Cerone, *How Branding Affects Consumer Behavior: The Impact on Purchase Decisions*, Lincoln Digit. Grp. (Feb. 23, 2024), https://lincolndigitalgroup.com/how-branding-affects-consumer-behavior-the-impact-on-purchase-decisions/.

74. Weng Marc Lim et al., *Past, Present, and Future of Customer Engagement*, 140 J. Bus. Rsch. 439 (2022) (discussing the rising prominence of customer engagement through branding since 2010).

75. *See New Research Reveals Influencers Significantly Drive Purchasing Decisions*, Sprout Soc. (Apr. 25, 2024), https://investors.sproutsocial.com/news/news-details/2024/New-Research-Reveals-Influencers-Significantly-Drive-Purchasing-Decisions/default.aspx ("nearly half of consumers make a purchase at least once a month because of influencers"). Platforms like Facebook, Twitter, and YouTube helped launch social media influencers in the mid-2000s.

76. *See Impact and Influence: The Effects of Influencer Culture on Society*, IZEA (Apr. 2, 2024), https://izea.com/resources/impact-and-influence-of-influencer-culture-on-society/ (today, digital influencers are more effective in driving consumer purchasing decisions than artist and sports celebrity endorsements); Fiona Simpson, *The Power of Brand in Franchising*, Forbes (Apr. 24, 2024), https://www.forbes.com/sites/fionasimpson1/2024/04/24/the-power-of-brand-in-franchising/ (consumers do not look behind the brand name "or even care" who owns the business they frequent: "They're spending their hard-earned cash there because it's a name that is familiar or comforting to them no matter where they are geographically . . . .").

77. To-Am Equip. Co. v. Mitsubishi Caterpillar Forklift Am., Inc., 152 F.3d 658, 659–60 (7th Cir. 1998) (admonishing inadvertent franchisors everywhere: "Legal terms often have specialized meanings that can surprise even a sophisticated party. The term 'franchise,' or its derivative 'franchisee,' is one of those words.").

78. Keating v. Superior Ct., 645 P.2d 1192, 1199 (Cal. 1982).

79. While the Burgerim enforcement case discussed *supra*, note 7, involved systemic franchise sales fraud, not accidental franchises, it illustrates the cataclysmic financial and reputational damage that can befall a brand that violates franchise laws. Burgerim is also a wake-up call about the potential enforcement clout of the FTC, which had seemingly paid no attention to franchisors since overhauling the federal franchise sales law in 2008. Like public labor law enforcement, franchise law enforcement is very much influenced by politics. Under the Biden administration, the FTC appeared to return to its activist roots. *See* Robert Reich, *The FTC Is Back to Being the Activist US Agency Progressives Sought in 1914*, Guardian (Jan. 12, 2023), https://www.theguardian.com/commentisfree/2023/jan/12/ftc-non-compete-agreements-biden-chair. Under Biden, the FTC awoke from a 12-year hibernation and exhibited more focused attention to regulating franchising than it had during the prior two administrations combined. Besides Burgerim, in March 2023, the FTC initiated a comprehensive review of the federal franchise sales law, soliciting public comments about certain franchisor practices. *See* Press Release, Fed. Trade Comm'n, FTC Seeks Public Comment on Franchisors Exerting Control Over Franchisees and Workers (Mar. 10, 2023), https://www.ftc.gov/news-events/news/press-releases/2023/03/ftc-seeks-public-comment-franchisors-exerting-control-over-franchisees-workers. On July 12, 2024, the FTC announced new enforcement policies aimed at franchisors and published an "issues spotlight" expressing "growing concern about unfair and deceptive practices by franchisers," naming franchise brands that franchisees complained were the worst offenders. *See* Press Release, Fed. Trade Comm'n, FTC Takes Action to Ensure Franchisees' Complaints Are Heard and to Protect Against Illegal Fees (July 12, 2024), https://www.ftc.gov/news-events/news/press-releases/2024/07/ftc-takes-action-ensure-franchisees-complaints-are-heard-protect-against-illegal-fees. As they did on the Burgerim case, federal and state franchise regulators coordinate their enforcement efforts. Also on July 12, 2024, the FTC reopened the public comment period on its March 2023 probe into franchisor practices, which had closed more than a year earlier and generated over 5,000 responses. And on October 16, 2024, the FTC concluded its second enforcement action in two years, ordering a franchisor that had promoted its restaurant opportunity as "licenses," not franchises as they really were, to pay a fine and offer rescission to its franchisees. Press Release, Fed. Trade Comm'n, FTC Takes Action Against Qargo Coffee for Franchise Rule Violations (Oct. 16, 2024), https://www.ftc.gov/news-events/news/press-releases/2024/10/ftc-takes-action-against-qargo-coffee-franchise-rule-violations. With Republicans taking control of the White House and Congress, the FTC will likely return to a far less activist, more pro-business, agenda, but whether the FTC resumes its pre-Biden administration hibernation is anyone's guess. None of the changes afoot at the FTC will, however, derail or abate private litigation over whether a particular commercial arrangement is a franchise or state franchise agency interest in regulating so-called "accidental" franchisors.

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