What Is a Franchise Fee Under California Law?

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In *Singh v. Wireless Vision, LLC*, Case No. 2:22-cv-01018, 2023 WL 2752584 (E.D. Cal. Mar. 31, 2023), a California federal district court ruled that an operator agreement between a T-Mobile dealer and Ameritel, a T-Mobile master licensee, was a franchise under the California Franchise Relations Act, CAL. BUS. & PROF. CODE § 20001 *et seq.* ("CFRA"). The decision would be unremarkable, in this author's view, had the court confined itself to the facts essential to its holding. However, the opinion embraced a seemingly extraneous argument: that the plaintiff's payments to designated third-party vendors to build-out the retail store to T-Mobile's design specifications were franchise fees under the CFRA. In so holding, in this author's opinion, *Singh* misconstrued California precedent and amplified confusion about when a business arrangement is really a franchise. This article exposes *Singh*'s apparent dicta, *i.e.*, its "statements … not necessary to the decision of the case," to prevent the dicta from flowering into binding precedent. *See* Marc McAllister, *Dicta Redefined*, 47 WILLAMETTE L. REV. 161, 166 (2011).

The Importance of Avoiding an Accidental Franchise

Why the fuss? Numerous companies depend on knowing the legal contours of what is, and is not, a franchise so that, if desired, they may legitimately structure their business arrangements to fall outside the ambit of franchise laws. Many articles address the legal risks of inadvertent or hidden franchises. *See, e.g.*, Robert A. Lauer & Howard R. Morrill, *Bringing Clarity to the Accidental Franchise Conundrum*, ABA 43RD ANNUAL FORUM ON FRANCHISING W-3 (2020); Ann Hurwitz & David W. Oppenheim, *You Don't Want to be a Franchise? Structuring Business Systems Not to Qualify as Franchises*, ABA

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34th Annual Forum on Franchising W-3, at 22 (2011); Rochelle Spandorf, *Structuring Licenses to Avoid the Inadvertent Franchise*, Landslide, Vol. 2, No. 4, at 35 (Mar./Apr. 2010). Determining franchise status can be complicated by dual regulation of franchises at the federal and state level, with each jurisdiction having its own definitional subtleties and mix of exclusions and exemptions, combined with sometimes contradictory judicial and regulatory interpretations. While all jurisdictions agree that franchise laws should be liberally construed, legislatures always intended for franchises to be a subset of all trademark licenses.

Sorting franchises from nonfranchise licenses is an uncertain process. The quality controls that trademark owners must retain over a licensee's trademark use closely resemble the marketing controls characteristic of franchises. Yet it is essential that business owners know when a trademark license or distribution arrangement is a franchise because, from a regulatory viewpoint, nonfranchise and franchise licenses are as different as day and night. Nonfranchise licenses are unregulated private consensual arrangements. Franchises, by contrast, are highly regulated with serious consequences for statutory violations. *See* Spandorf, *supra*, at 35 ("Franchise law violations carry significant penalties even if the inadvertent franchisor neither knew about the law nor had any intent to violate it.").

The most dependable way for a company to launch a nonfranchise network of independent licensees to market, sell, or distribute the company's goods or services, whether licensees are termed dealers, distributors, associates, affiliates, members, partners, teammates, or something else, is to eliminate the required fee element—a mandatory component of nearly all franchise definitions. This is the favored structuring solution of manufacturers and suppliers that sell products at a bona fide wholesale price to licensees for downstream distribution, and companies that market their goods or services through commissioned sales agents. Thus, a decision like *Singh* that arguably misapplies the law on what constitutes a "required fee" compounds the uncertainty that companies face in avoiding franchise laws legitimately.

Singh and the "Required Fee" Element of a Franchise Under the CFRA

According to the *Singh* complaint, plaintiff Singh and Ameritel entered into an Operator Agreement in 2017. By 2021, defendant Wireless Vision had assumed Ameritel's business, including the lease of the retail dealership where Singh sold T-Mobile service contracts. A year later, Wireless Vision terminated the Operator Agreement without explanation or cause. Singh was subsequently evicted from the store location, leaving behind the store's contents, including an investment of over $160,000 in fixtures and improvements to build the store to T-Mobile's specifications. Some portion of Singh's investment in fixtures and store improvements went to third parties designated by and unrelated to Ameritel.

Singh sued Wireless Vision claiming, among other things, that the Operator Agreement was a franchise and its termination without good cause violated the CFRA. The franchise status question arose when Wireless Vision moved to change venue to a New York court pursuant to the Operator Agreement's forum selection clause. Singh argued that, as a franchise, Section 20040.5 of the CFRA—which protects California franchisees from the expense and inconvenience of litigating in a non-California venue—voided the Operator Agreement's New York venue provision.

Whether the Operator Agreement was subject to the CFRA's venue provision depended on proving the agreement was a franchise as defined in CFRA Section 20001. The only definitional element in dispute was whether Singh had paid a franchise fee. CFRA Section 20007 defines "franchise fee" as "any fee or charge that a franchisee … is required to pay or agrees to pay for the right to enter into a business" unless the payment, directly or indirectly, does not exceed $100 annually or is otherwise expressly exempt. The complaint alleged that Singh paid Ameritel a $10,000 "good faith deposit" and rent, each exceeding the $100 per year CFRA threshold. Under the CFRA, a deposit, even if refundable, is a franchise fee. *See* Cal. Dep't of Fin. Protection & Innovation, Commissioner's Op. No. 74/3F, 1974 Cal. Sec. LEXIS 219 (Cal. Dept. Corps. Jan. 25, 1974) ("Refundable deposit is a franchise fee because it deprives distributor of the use of the funds for an indefinite period."). The rent paid by a franchisee to Ameritel to rent the business premises from Ameritel or its affiliate is also a franchise fee. *When Does an Agreement Constitute a "Franchise?"*, Cal. Dep't of Fin. Protection & Innovation, Release 3-F at § 1(2)(4)(9) (June 22, 1994), available at https://dfpi.ca.gov/commissioners-release-3-f/ (hereinafter "1994 Guidelines"). Because Singh had paid

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Ameritel a franchise fee for the right to operate as a T-Mobile dealer, the Operator Agreement was deemed a franchise. The court could have rested its franchise status conclusion here, but did not.

Instead, the court embraced Singh's additional argument that Singh's payments to unrelated third parties designated by Ameritel to build-out the premises as a branded T-Mobile store were franchise fees, even though the opinion recites that Ameritel collected and remitted these payments to various third parties and kept nothing for itself. In a footnote, the opinion mentions that Singh claimed "that T-Mobile and Ameritel may have directly received payments for certain fixtures and materials" from the money Singh paid to designated third-party vendors, which Wireless Vision disputed, but the court left this pivotal issue unresolved and did not probe further. *Singh*, 2023 WL 2752584, at *7 n.7. Had third-party vendors remitted to Ameritel a portion of the proceeds from their transactions with Singh, this might qualify as a franchise fee. However, by leaving this disputed fact unresolved, the court tacitly endorsed the view that payments to third parties unrelated to the franchisor may be franchise fees even when the third party remits no portion of the franchisee's payment to the franchisor.

The fact that Singh's payments "ultimately went to third parties," the *Singh* court said, was "inapposite" to classifying them as franchise fees. The court held that payments to unrelated third-party vendors are franchise fees when a franchisor directs a franchisee to pay designated third parties in exchange for the licensing rights. The court treated payments to designated third parties as payments for the *benefit of the franchisor*, citing as authority a passage from the 1994 Guidelines, at § 1(2)(4)(8), on when payments to third parties are franchise fees. *Singh*, 2023 WL 2752584, at *7. But the particular passage in the 1994 Guidelines that the court relied on pertains to a readily distinguishable situation: where, as a condition of receiving franchise rights, a franchisee must pay off a debt that the franchisor owes to the third party—for instance where a franchisee must lease space from the franchisor-subtenant and is instructed by the franchisor to pay rent directly to the third-party property owner. This particular regulatory guidance does not bear on whether third-party payments made at the direction of a franchisor that do *not* discharge the franchisor's debt constitute franchise fees. Significantly, the *Singh* court ignored the following declaration by California's franchise agency in the same 1994 Guidelines explaining that: "*A payment to, or for the account of, third parties not affiliated with the franchisor is not a 'franchise fee' . . . even though the franchisee is required by the agreement to make such payment and even if the franchisor collects it from the franchisee on behalf of the third party*" (*emphasis added*). 1994 Guidelines, at § 1(2)(4)(8) (emphasis added).

Singh cited two cases interpreting the "franchise fee" definitional element in the CFRA: *Boat & Motor Mart v. Sea Ray Boats, Inc.*, 825 F.2d 1285 (9th Cir. 1987) and *Thueson v. U-Haul Int'l Inc.*, 144 Cal. App. 4th 664 (Cal. Ct. App. 2006), to support its interpretation that payments to unrelated third parties may be franchise fees. In this author's view, *Singh* misconstrued both precedents.

Sea Ray Boats considered whether a dealer's third-party payments for various promotional expenses were franchise fees under the CFRA. *Singh* quoted what it called the "holding" in *Sea Ray Boats,* that payments to a third party "at the behest of [the franchisor]" qualify as a franchise fee. *Singh*, 2023 WL 2752584, at *6 (quoting *Sea Ray Boats*, 825 F.2d at 1290) (alteration in original). When the Ninth Circuit decided *Sea Ray Boats,* it acknowledged that whether third-party payments were franchise fees was a question of first impression in California, but cited out-of-state precedent interpreting the same issue under comparable statutes, remarking that "payments made to parties other than the franchisor have regularly been regarded as *not* constituting fees." *Sea Ray Boats*, 825 F.2d at 1289-90.

The dealer in *Sea Ray Boats* sought over $1 million dollars in damages at a time when the CFRA's exclusive remedy for wrongful termination of a franchise was the repurchase of inventory. Because the dealer had failed to prove a right to recover damages even if the CFRA applied, the Ninth Circuit declined to decide whether the dealer's third-party payments were a franchise fee. The Ninth Circuit stated unequivocally: "We abstain from deciding whether a franchise fee was paid." *Id*. Thus, the passage in *Sea Ray Boats* that *Singh* calls a "holding" was merely *dicta*. *Singh*, 2023 WL 2752584, at *6; *also see* Philip F. Zeidman & Bret Lowell, Legal Aspects of Selling and Buying § 9:37 (3d ed.) (June 2021) (calling the *Sea Ray Boats* discussion of franchise fees "dicta").

Thueson was decided nearly 20 years after *Sea Ray Boats* and remains the only California state court decision interpreting the "franchise fee" element in the CFRA's franchise definition. It considered whether U-Haul's charges to a dealer

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for a local telephone line, directory listing, and computer terminal totaling approximately $40 per month were franchise fees under the CFRA. A close reading of *Thueson* reveals that the dealer was a commissioned sales agent who never paid U-Haul anything to be appointed a U-Haul dealer. Instead, the parties' arrangement required the dealer to collect all rental fees from customers and remit them to U-Haul, in exchange for which U-Haul paid the dealer a commission after deducting the communication-related charges. The deductions did not amount to the dealer paying U-Haul an indirect franchise fee because the amount deducted was not the dealer's money; the dealer's interest was in receiving the net commission. *Thueson* ruled the dealership was not a franchise because the dealer had not paid U-Haul a franchise fee.

Singh cited *Thueson* to contrast the U-Haul dealer's relatively small $40 per month "payments" found to be ordinary business expenses with Singh's "significant, unrecoverable, and firm-specific investments in a T-Mobile store." *Singh*, 2023 WL 2752584, at *6. But *Singh's* effort to distinguish *Thueson* was superfluous since *Thueson*, in fact, is a commission deduction case, meaning the dealer made no payments at all to U-Haul. Thus, it made no difference if the deductions taken by U-Haul from the dealer's gross commission were for charges ordinary for anyone in the business of renting vehicles; the dealer's interest was in receiving a net commission. Deductions taken out of a commission are not franchise fees because no money flows from a franchisee to a franchisor; instead, the money flows in reverse. That California law endorses this view is confirmed by twin 1971 interpretative opinions issued by California's franchise agency holding commissions not to be franchise fees. Cal. Dep't of Corp., Interpretive Op. No. 71/14F, 1971 Cal. Sec. LEXIS 223 (Mar. 17, 1971) and Cal. Dep't of Corp., Interpretive Op. No. 71/17F, 1971 Cal. Sec. LEXIS 222 (March 18, 1971). Like the commission in *Thueson*, none of Singh's investment to build-out its branded TMobile store arguably flowed to Ameritel or, for that matter, T-Mobile.

Singh argued that it was unfair for Ameritel to require Singh to spend significant money to improve Ameritel's space and not compensate Singh for these improvements when, following termination, Singh had to leave these improvements behind because under well-accepted principles of real property law, as fixtures, the improvements belonged to the landlord, which was Ameritel. Here lies the crux of the *Singh* court's reason for finding Singh's payments to unrelated third parties to be a franchise fee: even if the payments entirely went to third parties, they improved Ameritel's space, and the modifications and upgrades funded by Singh's payments, "remained in defendants' possession and control." *Singh*, 2023 WL 2752584, at *7. But it was entirely unnecessary to the court's franchise finding for the *Singh* court to declare Singh's third-party payments to improve the leased premises a franchise fee given the uncontestable franchise fees that Singh had paid. Furthermore, CFRA Section 20035 compensates a wrongfully terminated franchisee with the fair market value of the franchised business, Singh would have been compensated for the improvements that he paid for and had to leave behind in Ameritel's space. The CFRA remedy, however, was not meant to turn payments to unrelated third parties for building improvements or other things when required by the parties' contract into a franchise fee when the third party remits no portion of the franchisee's payment to the franchisor.

Exposing *Singh*'s Dicta

There is no judicial precedent of which this author is aware interpreting "franchise fee" under any franchise law that would cover Singh's third-party payments—for good reason. Such an interpretation would make every payment by a dealer or licensee to a third party to fulfill a contractual duty a franchise fee. Thus, franchise fees would be deemed to be paid when a dealer pays third-party carriers for travel to attend mandatory sales meetings or training, buys advertising from third parties to fulfill a duty to conduct local advertising, or pays building contractors and designers to transform vacant space to resemble a brand owner's trade dress. If contractually required third-party payments were franchise fees, every license, dealer agreement, and commissioned sales agency would be a franchise even though none of the third-party payments result in any transfer of wealth to the franchisor.

There exists tremendous confusion among courts across jurisdictions interpreting the franchise fee definitional element. One reason for the confusion is because of judicially invented concepts that a franchise fee must be a "firm specific, unrecoverable investment"

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and not an "ordinary business expense." These twin concepts, "firm specific, unrecoverable investment" and "ordinary business expense," are opposite sides of a franchise fee coin. Yet, no statute uses these imprecise, undefined phrases to explain what a franchise fee is or is not. *See* Sandra Gibbs, *Hidden Fees: Seeking a Rational Paradigm*, 39 Fran. L. J. 394, 505 (2020). The phrases seem judicially grafted to prevent every license from becoming a franchise. And, while *Thueson* embraced the dichotomy between "ordinary business expenses" and "firm specific, unrecoverable investments" without explaining either phrase, its discussion was entirely gratuitous because the commissioned dealer in *Thueson* made no payment to U-Haul or for U-Haul's benefit, ordinary or otherwise, for the right to rent U-Haul vehicles.

The logic of the *Singh* court appears to be that, if the relatively small monthly "payments" in *Thueson* were ordinary business expenses, then the opposite must be true about the substantial payments that Singh made to improve Ameritel's premises: they must be franchise fees. But *Singh's* hypothesis is predicated on a flawed analysis of *Thueson* and *Sea Ray Boats* and ignores the referenced 1994 Guidelines explaining that payments to third parties not affiliated with a franchisor are not franchise fees even if required by the parties' agreement. Most problematic is that *Singh's* flawed articulation of what qualifies as a franchise fee under California law was completely unnecessary to finding the Operator Agreement a franchise, given that the deposit and rent that Plaintiff Singh undisputedly paid Ameritel each satisfied the franchise fee requirement.

Dicta is dangerous because at its extreme, a later court may treat dicta as formally binding precedent. Marc McAllister, *Dicta Redefined*, 47 Willamette L. Rev. 161, 161-62 (2011). Given the uncertainty, but importance, of parsing franchises from non-franchise licenses, the *Singh* decision leaves us with a difficult precedent out of line with the prevailing view that a franchise fee is a payment to a franchisor or a third party to discharge the franchisor's debt, not payments to third parties simply because the party with contract power directs that the third-party payment be made. Based on the court docket, it appears *Singh* has settled without appeal, leaving the arguably troubling decision on the books for the franchise bar to deal with. The best way to contain *Singh* is to call out its flawed analysis as non-binding dicta. ■

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