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# BEWARE THE INADVERTENT FRANCHISE

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# HOUSEKEEPING ITEMS

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# THE TRAP

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

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



# A ROSE IS A ROSE

Franchise laws are complex and definitions vary resulting in potential landmines

- No universal definition – Federal and State
- Easy for the untrained to overlook a franchise
- Name given doesn't matter – “licenses” or “distributorships” can still be franchises



# TRUTH OR CONSEQUENCES

**Illinois Mitsubishi Forklift Dealer - \$1.525M million to a terminated forklift distributor**

**New Hampshire beer manufacturer - \$10.2M plus attorneys fees for failure to give written notice and opportunity to cure. - *Globe Distributors v. Adolph Coors Co.***



# ATTORNEY LIABILITY

Attorneys for marketer of health and fitness business opportunities sued for malpractice for failing to advise a client that it was subject to the Connecticut Business Opportunity Law.

- *Beverly Hills Concepts, Inc. v. Schatz & Schatz, Ribicoff & Kotkin*

Attorney missed the statute of limitations for a terminated dealer for not recognizing that the relationship was protected under the Illinois franchise law. 7th Circuit rejected plaintiff's argument that "the Franchise Act is so complicated and obscure very few attorneys understand how it works or even know of its existence."

- *Pyramid Controls Inc. v. Siemens Industrial Automation, Inc.*



# WHAT IS A FRANCHISE?





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# FEDERAL LAW

- Required payment (fee) – does not include purchases at bona fide wholesale prices
- Continuing control or assistance
- Association with trademark

***But there are: Exemptions and Exclusions***



# EXEMPTIONS – FEDERAL LAW

- Fractional franchise: (i) franchisee has engaged in same type of business for 2+ years, and (ii) parties anticipate sales from the franchise to be less than 20% of sales in dollar volume of the franchisee
- Payments from franchisee to franchisor within 6 months of franchisee commencing operations is less than \$500
- Leased Departments
- Purely Oral Agreements
- Petroleum Marketers and Resellers
- Large Investment Exemption
- Large Franchisee Exemption
- Insider Exemption



# EXCLUSIONS – FEDERAL LAW

- **Employer/employer or general business partner**
- **Cooperative association**
- **Trademark license for a service to evaluate and certify goods**
- **Single trademark license**



# STATE LAWS

- ***Marketing Plan or System*** prescribed in substantial part by franchisor plus a franchise fee and substantial association with trademark OR
- ***Community of Interest*** in marketing goods or services using franchisor's trademark plus a franchise fee

***But:***

- ***New York*** – either a “marketing plan” and a fee or “trademark license” and a fee



# LAWS GOVERNING FRANCHISES

- **FEDERAL TRADE COMMISSION RULE ON FRANCHISING**
  - Only governs disclosure
  - Does not govern the franchise “relationship”
  - No registration at federal level
  - No private right of action
  - Potential for personal liability

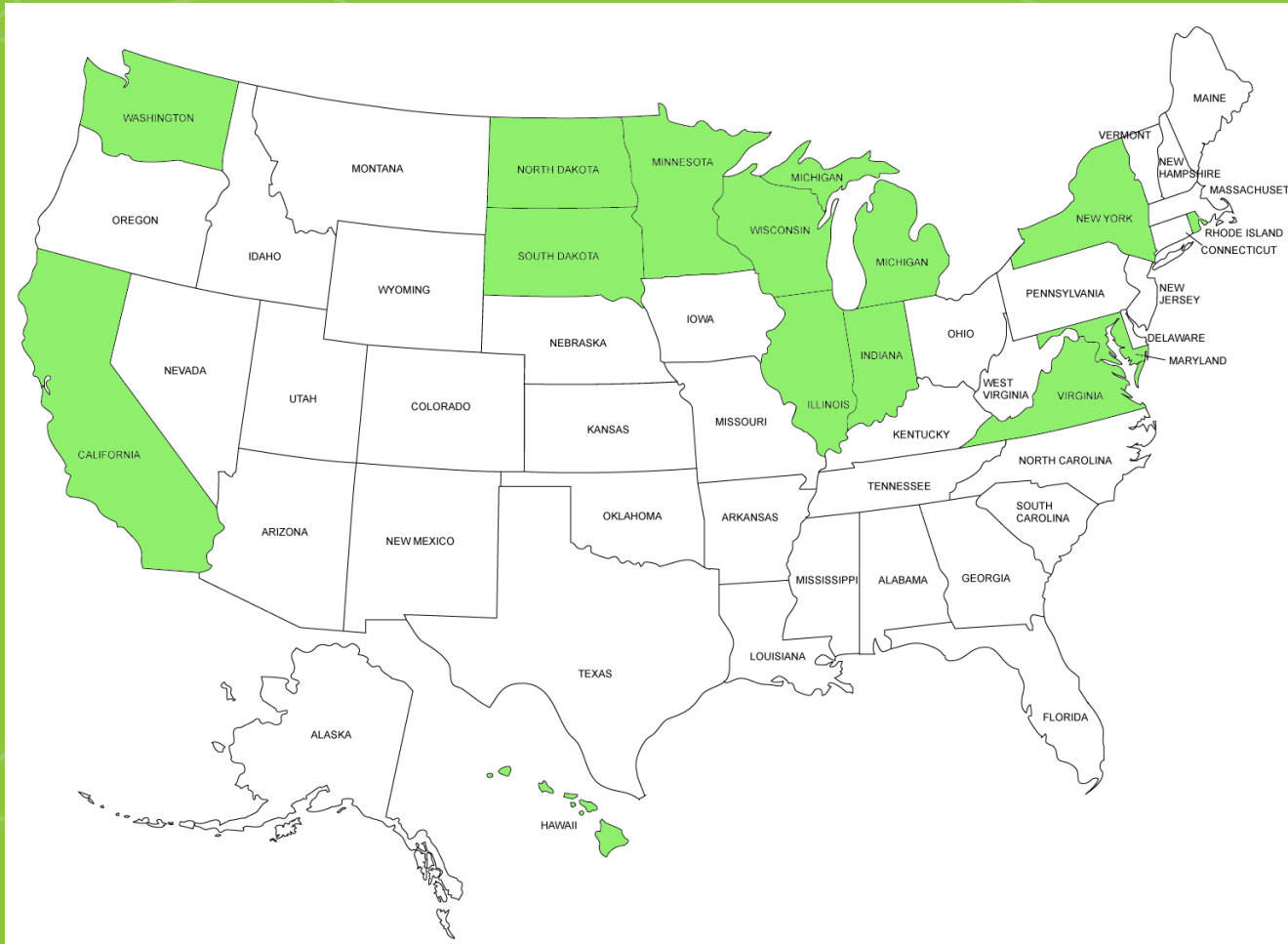


# LAWS GOVERNING FRANCHISES

- **STATE FRANCHISE DISCLOSURE AND REGISTRATION LAWS**
  - **Governs both registration and disclosure**
  - **Possible criminal and civil penalties**
  - **Private right of action**
  - **Potential for personal liability**
  
- **SPECIAL INDUSTRY LAWS**



# REGISTRATION STATES



# STATE RELATIONSHIP LAWS

- **Termination**
- **Renewal**
- **Other**





# INADVERTENT FRANCHISES

**Appliance Dealer**

**Automobile Parts Dealer**

**Basketball Team**

**Cafeteria in Office Building**

**Computer Training System**

**Copy Machine Distributor**

**Furniture Dealers**

**Internet Providers**



# INADVERTENT FRANCHISES

Law Firm Branch Office

Magazine Distributorship

Medical Practices

Office Products Dealer

Sales Representatives

Slot Machine Manufacturer

Snack Distributorship

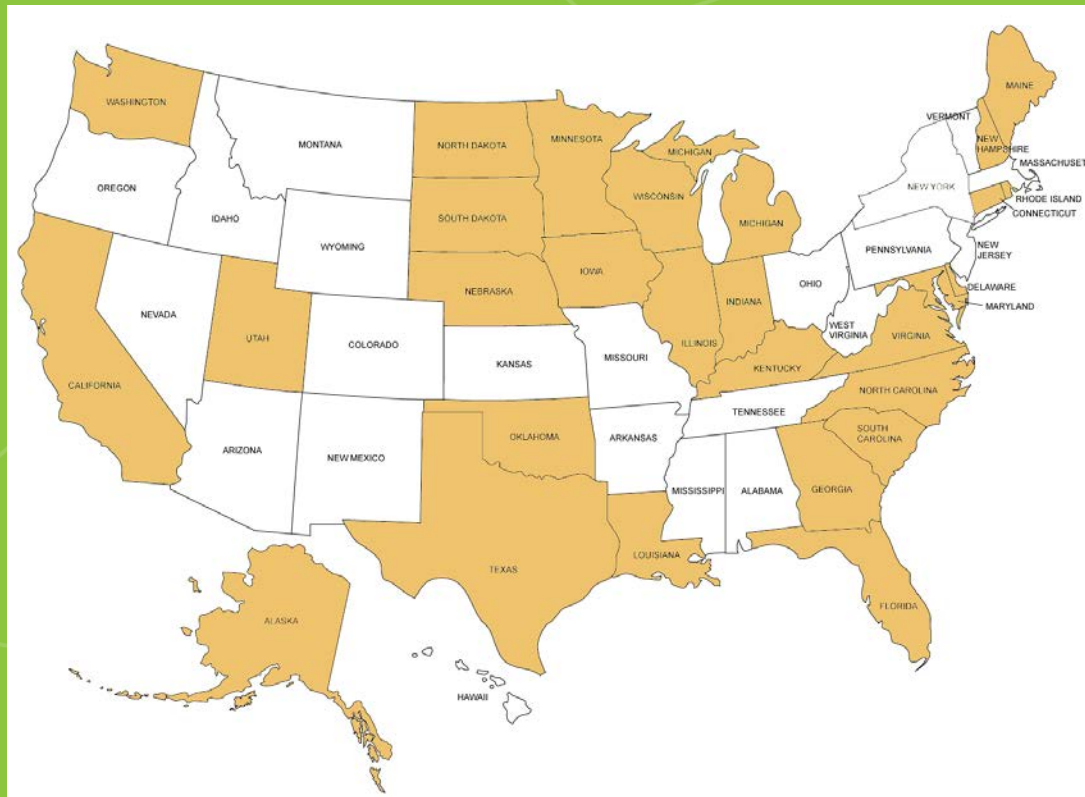
Sports Information Service Provider

Sublease Agreement for Pet Shop



# BUSINESS OPPORTUNITY LAWS

Offers made by sellers of the business opportunity to purchasers, verbally or in writing, under which the seller will provide or sell products, equipment, supplies or services that will enable the purchaser to start the business.



# ALTERNATIVES TO FRANCHISING

- **Granting a license to make or use a product, invention, or secret process**
- **Granting a trademark license to use a particular trademark in connection with the sale or use of a product or service**
- **Direct distribution by the producer to the public or to retailers who sell to the public**
- **Management agreements**



# ALTERNATIVES TO FRANCHISING

- **Consignment operations**
- **Sale of company-owned outlets**
- **Agency or supply relationships**
- **Independent manufacturer's representatives who sell products of one or more manufacturers**
- **Sale of goods only at bona fide wholesale prices**



# PRACTICE POINTERS

- **LOOK FOR THE ELEMENTS OF A FRANCHISE, REGARDLESS OF THE NAME GIVEN TO THE RELATIONSHIP**
- **THINK FRANCHISE WHENEVER THERE IS A TRADEMARK LICENSE**
- **CHECK EXEMPTIONS AND EXCLUSIONS**
- **CHECK FOR SPECIAL INDUSTRY LAWS**
- **DON'T RELY ON DISCLAIMERS**



# MORE PRACTICE POINTERS

- **CAREFULLY REVIEW STATE STATUTES**
- **DON'T FORGET BUSINESS OPPORTUNITY LAWS**
- **OFTEN EASIER TO COMPLY RATHER THAN TRYING TO FIND A LOOPHOLE - AVOIDING CLASSIFICATION AS A FRANCHISE CAN IMPAIR MARKETING CONCEPTS AND ECONOMIC OBJECTIVES**
- **DON'T RELY ON WHAT THE FRANCHISE AGREEMENT SAYS**
- **EDUCATE CLIENTS**

