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FRANCHISING

Evelyn M. Sommer

I. Introduction - What is a Franchise?

A. A system of marketing and distribution whereby a small independent businessman (the franchisee) is granted — in return for a fee — the right to market the goods and services of another (the franchisor) in accordance with the established standards and practices of the franchisor, and with its assistance.[1] Franchising can be defined as a business system in which the owner of a mark licenses others to operate business outlets using a trademark or service mark to identify products or services that are made and/or advertised by the licensor-franchisor. In one sense, a franchise system is built upon a framework of trademark or service mark licenses fleshed out with various rights and obligations of the franchisor and franchisee. A franchisee falls somewhere on a spectrum in between full independent entrepreneur and a hired clerk in a company-owned outlet.

Tied to the definition of a "franchise" is a clear conception of the peculiar blend of independence and dependence that constitutes the particular business arrangement that is franchising. On the hand, in a franchise relationship, the franchisee possesses an independence conferred by the franchisor insofar as the franchisee is granted the right to actually operate and own the franchise business. Part and parcel of this business independence is also financial independence; concomitant with the task of running the business, the franchisee bears the risk of failure if the business is not successful. Indeed, the franchisee actually purchases the right to operate and own the business from the franchisor by paying a "franchise fee." On the other hand, the franchisee is also peculiarly dependent upon the franchisor insofar as the success of a franchise depends, in part, upon the method of operation provided by the franchisor and, in part,

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upon the preeminence and popularity of the commercial identity embodied in the franchisor's proprietary marks. This particular convergence of independence and dependence is the hallmark of a franchise.

B. At the core of all franchising is the licensing of a trademarked product or service.[2]

A trademark license is usually the core of a franchise relationship. The license to use the trademark is the vehicle for the franchisee to become part of a business system with uniform format and quality standards. The necessity and the role of the trademark license depend on the type of franchise system at issue.

A trademark license is necessary if the franchisee manufactures and sells a product bearing the trademark to someone other than the trademark owner or those operating under license from the trademark owner.

It is also necessary if the franchisee uses the trademark in performing a service under license from the trademark owner, for example, as part of a franchising system.

A trademark license is not necessary if one party merely distributes or sells the product for the trademark owner without conducting business under the owner's mark or name. For example, a gas station franchisee does not need to obtain a trademark license from soda producers to sell sodas.

The license is also unnecessary if one party manufactures the product for the trademark owner (or its licensees) and the trademark owner itself (or licensee) sells or distributes the product. For example, manufacturing T-shirts for the trademark owner's promotional use does not require a trademark license.

C. Some franchisors maintain that a franchise is merely an embellished license and therefore revocable at will.

D. Some franchisees contend that a franchise is a license coupled with a fiduciary interest, not subject to unlimited control by franchisors.

E. Because of this dispute, a universal definition for "franchise" does not appear in every jurisdiction's legislation, court decisions or regulations, and if such a definition did exist, it would fail to encompass the many functions inherent in the system. Moreover, such a definition would not give any indication of the system's complexity and potential for abuse.

F. The term "franchise" has been used to describe a vast array of different business arrangements involving any number of enterprises. As one author has noted, defining what constitutes a franchise is particularly difficult because franchising itself "embraces many types of relationships and distribution techniques, involving [a] . . . myriad . . . [of] products and services [including] such disparate bed-fellows as auto manufacturers, motels, muffler repair shops, restaurant operations, and funeral homes for pets." Norman D. Axelrod, *Franchising*, 26 Bus. Law 695 (1971). Another commentator attributed a large part of the difficulty of properly framing a definition of franchising to legislative zeal in seeking to cover all conceivable business arrangements. Martin D. Fern, *The Overbroad Scope of Franchise Regulations: A Definitional Dilemma*, 34 Bus. Law, 1387 (1979).

G. One proposed definition states that a franchise is "an oral or written arrangement for a definite or indefinite period, in which a person grants to another person a license to use a trade name and in which there is a community of interest in the marketing of goods or services at wholesale, retail, leasing, or otherwise in a business operated under said license."[3]

New York General Business Law Art. 33 at § 681 defines a franchise as a contract or agreement, either expressed or implied, whether oral or written, between two or more persons by which:

1. A franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor, and the franchisee is required to pay, directly or indirectly, a franchise fee, or

2. A franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising, or other commercial symbol designating the franchisor or its affiliate, and the franchisee is required to pay, directly or indirectly, a franchise fee.

H. While there are many different forms and kinds, franchises may be divided into four basic types.

1. A manufacturing franchise is one in which the franchisor permits franchisees to make and sell products using either raw materials and/or specifications supplied by the franchisor. Examples are mattress and bedding manufacturing and the local bottling and canning of soft drinks.

2. A distributing franchise is one in which the primary purpose is for the franchisee to serve as an outlet for products manufactured by or for the franchisor. Examples are franchised sales outlets for bicycles, automobiles, and gasoline.

Its purpose is to provide the franchisor with a distribution system to market its products. It is similar to an ordinary supplier-dealer relationship, but the franchisee has a greater identification with the franchisor's trademark and might be precluded from selling competitors' products. Examples include gas stations and automobile dealerships.

3. A licensing or "business format" franchise is one in which the franchisor is primarily licensing a business format or system, rather than selling goods identified with the franchisor. Under a business format franchise relationship, the franchisor provides a license under a mark and also provides a business format for the retail sale of goods or services under the mark. The franchisor typically does not manufacture any products but may offer to supply equipment, ingredients, raw materials, packaging materials, advertising, and so forth. The franchisee typically performs services but may sell products in conjunction with those services. The franchisee usually deals exclusively in the franchisor's sponsored services and is required to adopt the franchisor's mark and overall presentation format as its exclusive trade identity. Examples include restaurants, hotels and motels, and auto repair, car rental, and temporary employment services. The best known example is the fast food franchise. In this type of franchise, the franchisee is primarily paying for the use of a franchisor's well-known and advertised mark together with training, operating specifications, and business know-how supplied by the franchisor.

4. Under an affiliation franchise relationship, the franchisor recruits into its system as licensees persons who are already established in the particular line of business. Each of the businesses is required to adopt and use the franchisor's mark, but they may be permitted to continue using their own marks as secondary marks. These businesses rarely use the same overall presentation or identity format except for the mark itself. Examples are insurance, financial, and real estate brokerage services.

II. Mutual Business Contributions

A. Theoretically, franchising represents the ideal compromise between big business and small businessmen. The franchisor assumes the economic functions of big business, and the franchisee contributes capital and entrepreneurship by becoming an owner-manager.[4]

B. The franchisor obtains new sources of expansion capital, new distribution markets and self-motivated vendors of its products, while the franchisee acquires the products, expertise, stability and marketing savvy usually reserved only for larger enterprises.[5]

C. Franchising is the evolutionary business response to the massive amounts of capital required to establish and operate a company-owned network of product or service vendors.

D. As the United States became more industrialized in the late 18th and early 19th centuries, national brands and nationally known vendors came into being and reworked the American economic landscape.[6]

E. Franchised businesses now account for approximately $803.2 billion in annual sales, 30% of the Gross National Product and over 40% of all retail sales. One of every 12 businesses in the United States is a franchise operation. Over 8 million people in over half a million outlets are employed in franchise operations.[7]

III. Business Advantages of Franchises

From the franchisor's point of the view, the franchise method is advantageous because it permits the franchisor to quickly set up and maintain a relatively large number of outlets using the capital investments of the franchisees. From the franchisees' point of view, the franchise method is attractive because the franchisee is given access to a proven and organized product or service that has been advertised and is known to customers. Rather than start from

zero with its own mark and its own know-how, a small business person who opts to become a franchisee has the advantage of plugging into a existing system and becoming a partially independent entrepreneur.

Franchisor's Benefits

A. In the ideal situation, the franchisor has almost unlimited opportunities to perform valid functions and be richly rewarded for that effort. At the inception, franchisees are independent businessmen, providing the talent, inspiration and enthusiasm epitomized in the phrase "local entrepreneur." They can decipher local requirements because of their direct customer contact. The goodwill engendered in that contact is meaningful as well. These attributes are frequently cited as the most fundamental attraction for the franchisor.[8]

B. The franchisor — without the expenditure of any capital whatsoever, but instead with an infusion of capital — may engage in rapid system expansion and market penetration. This rapidity of growth is normally measured in terms of years rather than decades, as had previously been the case with national company owned chains. Further, since the franchisor often owns units itself, and since those units are normally more profitable than franchised units, the franchisor will frequently set up a nationwide network but retain for itself the most profitable units. Finally, the franchisor acquires the aggressive self-motivation of franchisees, whose ownership fervor is generally far greater than that of employee managers.[9]

C. In the purely financial sense, the franchisor may reap generous rewards from a variety of sources. It may obtain a substantial fee for the sale of the franchise, regardless of whether the fee is paid in full or paid in installments. In the service industries, the franchisor will usually charge a royalty for the use of the mark and the business system. This may consist of a percentage royalty on gross sales or purchases, a fixed monthly charge, or any of a wide variety

of methods that reflect payment based on usage. Additionally, where the franchisor is also the manufacturer or wholesaler for any of the products or services used by the franchisee, the franchisor has an opportunity to obtain a profit for its valid functions. The availability of an assured distribution network may considerably increase the manufacturer's profits by reducing the need for large inventory, by providing an assured demand, and by eliminating wide fluctuations in sales and close-outs. Further, there may be other economies of scale in the production, storage, and handling of products.[10]

D. Other indirect sources of income that do not transgress the rules of fair play and disclosure are available to the franchisor. For example, the franchisor may provide an extensive credit network, both to the franchisees and to their customers. One step removed from this would be the indirect extension of credit by the acquisition of capital facilities through purchase, lease, mortgage, or otherwise, with possession or use being made available to the franchisee on reasonable terms commensurate with the franchisor's exposure to risk. In some industries, this financial support may extend to the inventory itself.[11]

E. Non-financial benefits to the franchisor includes the ability to motivate and control huge numbers of indirect employees. A company may not be able to afford the cost of an administrative hierarchy, including high salaries, to handle those employees. Franchisors also avoid a certain amount of risk inherent in most businesses. Whether a regional milk dairy or a major oil company, it may be absolutely dependent upon an assured and constant source of demand for its products or may lack adequate local storage to offset the vagaries of market demand. The franchisor also receives the benefit of the constant accretion to the value of its trademark or service mark. The actual premises, the franchisee's services and their devotion to

duty all materially enhance the mark's value to the franchisees, to other franchisees and to the franchisor.[12]

IV. Franchisee's Benefits

A. At inception, the franchisor should provide a trademark or service mark that is nationally known. The purpose is to provide an attractive reputation that is recognized by the consumers with whom the franchisees will deal. In an ideal situation, the franchisee's success lies in complying with the standards formulated by the franchisor, both as to quality and as to uniformity. This emphasis is meant to facilitate the obtaining and maintenance of the nationally-known goodwill for the products or services. While fulfilling these obligations to the customer, the franchisee benefits by the guidance provided by the franchisor in the form of business standards. The franchisee should obtain internal benefits from a standardized management system and methods of internal control, including marketing and inventory controls and standardized bookkeeping. The franchisee will benefit externally from producing better results in its individual operations, while increasing customer acceptance throughout the system.[13]

B. Franchisor can also provide expert guidance in capital matters like site selection, design and engineering of the facility, layout, choice and sources for equipment, furnishings, supplies and even general contractor services. Where facilities are to be leased or purchased, the franchisor may provide expert advice, negotiating talent, or financial assistance through a pledge of credit. In the operation of the enterprise, the franchisor should provide a proven system of operations through training, a Manual of Operations, supervision, research, bulletins and refresher courses. There may be extensive benefits obtainable through bulk purchasing, buying techniques, or sources of supply. Where the franchisor is a manufacturer, the franchise family

can provide a variety of cost-savings that can be passed down the line. All of this may be enhanced by the constant availability of the franchisor's highly-trained team of experts. These advantages are what franchisees usually seek. They are what franchisors impliedly offer. Underlying the franchisor's promise and the franchisee's goal is the offering of a business in which the franchisee will have a reasonable opportunity to succeed in developing a business of her own.[14]

V. Structuring a Franchise System

A. For the most part, a prospective franchisee has little choice but to put his entire faith and confidence in the franchisor. The franchisee most often assumes that the franchisor has worked out a functional system for merchandising his product or services, and that the system can work for the mutual benefit of both parties. In order for that to really happen, the franchisor must try to assemble all of the expertise that may be required in the particular business in which he proposes to engage. Unfortunately, many franchisors think of their prime business as being that of the sale of franchises, rather than the operation of the franchise that may be purchased by the franchisee. For this reason, a franchisee must engage not only an attorney to draw up a set of documents, but also and primarily a business team to gather all the expertise in the creation of the entity from which the franchise will operate. From sources of supply to advertising, to orders, payments, credits, discounts, the franchisee must look to the franchisor for total guidance in every material aspect of the franchise relationship.[15]

B. Franchising is a creature of contract. The entire structure of a franchise system will be contained in a series of franchise agreements, which set forth in detail the rights, duties, obligations and activities which each party pledges to undertake and perform. A number of different species of franchise agreements and relationships may exist to properly implement the

franchisor's business objectives, including unit franchises, area franchises, master franchises and subfranchises. The core relationship, however, is the unit franchise relationship in which a franchisee is given the right to open and operate one — and only one — franchise outlet, usually at a specified location and within a designated territory. Accordingly, a potential franchisor's central question is how the unit franchise relationship should be memorialized in a franchise agreement to properly protect and advance the franchisor's interests and goals.[16]

C. The beginning point of the franchise relationship is the terms of the franchise relationship. How long is the franchisor granting franchise rights to its franchisees? This is not an easy question to answer. On the one hand, if the term is too short, it will attract few, if any, buyers. Franchisees are purchasing a business opportunity where time is needed to develop name recognition, to maximize good will and to recoup their investment. On the other hand, if the term of the franchise is too long, problems can arise. The franchisor may be stuck with a less than desirable franchisee who is unwilling or unable to operate the franchise successfully. If this is so, valuable locations may be sacrificed. Also, since many franchise agreements call for franchisees to upgrade and refurbish their franchise locations at the end of the franchise term and upon renewal, too long a franchise term can result in older franchise units downgrading the image the franchisor is trying so hard to present.[17]

D. Finally, franchise terms that are excessive in length prevent the franchisor from adjusting the economics of the relationship as time goes on. In other words, the economic balance struck this year in terms of royalties and advertising contributions may be totally out of line in the year 2010, either to the franchisor's or the franchisee's disadvantage. While this imbalance can be rectified upon expiration of the initial term of the franchise, if that term is too long, the imbalance can destroy a franchise system.[18]

E. Another key feature of the franchise structure is the grant of territorial rights. It is most common for franchisors to confer upon franchisees some degree of territorial protection for their businesses, often under the misleading heading "exclusive territory." This is misleading because no franchised territory is ever truly "exclusive." If nothing else, termination of the franchise agreement defeats any claimed "exclusivity." Also, while the franchisor can promise not to own or franchise other units within a franchisee's territory, a franchisor is hard pressed to prevent its franchisees from marketing in other franchisees' territories. Such restraints may constitute violations of applicable antitrust laws. For this reason, many franchisors include a recital in the franchise agreement that no marketing exclusivity is conferred in connection with a grant of a so called "exclusive territory."[19]

F. Selection of the franchise location and the construction of the franchise unit are of prime importance in structuring a franchise system. A franchise agreement will state whether the franchisor or franchisee will select the franchise site. Where the franchisor is responsible for this, a clause stating that any responsibility for assuring that the site will be successful will be included in the franchise agreement. Where it is the franchisee's choice, the franchisor will insure that the franchisee follows the appropriate standards and specifications with regard to any location selected by including such a clause in the agreement. Franchise or approval of any franchisee-selected site should always be provided for. Further, any relocation rights should be addressed as well. That is, the franchise agreement should specify whether a franchisee will be permitted to close a location and relocate the franchised business and, if so, under what conditions. It is not uncommon for franchisors to insist on prior written approval, coupled with the right to conduct an on-site inspection of the new site and the right to impose a relocation fee.[20]

G. There are several different ways the franchise relationship can be structured. Two types of franchise relationships are the individual or unit franchises and area franchises.

Individual or unit franchises are those in which a franchisee is granted the right to develop and operate one outlet at a specific location or within a defined territory. Rights to acquire additional franchises may be granted within a defined area, subject to performance criteria and structured as either options or rights of first refusal. Rights of first refusal, however, will make it more difficult to attract qualified buyers for locations that are subject to such rights.

Unit franchises may also be offered as an incentive for growth for existing franchise owners, with additional franchises granted to successful franchisees. Franchisors should exercise caution in granting any sort of contractual obligation to grant additional unit franchises. Most companies simply adopt company wide policies regarding the incentive program.

The typical uses of an individual or unit franchise are as follows:

1. For a service business, in which the expertise of the franchisee is critical to the success of the operation. Some examples of service businesses are real estate, home inspection, and dental businesses.

2. For businesses requiring an owner-operator.

3. For active investors who are willing to "get their hands dirty." This type of franchise would not be appropriate for a passive investor.

Area franchises are those with multiple outlet franchises or area development agreements and may include subfranchisors and master franchisors. Under these arrangements, a franchisee may be granted the right to develop and operate two or more outlets within a defined

territory or, in some instances, the right to subfranchise some of these development responsibilities. Following are the significant elements of an area franchise agreement:

1. Territory and exclusivity
2. The number of outlets to be developed
3. The time frames for development
4. Franchisor assistance in development
5. Fee obligations
6. Site selection and approval responsibilities of the parties
7. Termination and its consequences (i.e., the effect of termination of the development agreement on existing individual outlet franchises and the effect of termination of outlet franchises on the development agreement and other outlet franchises must be addressed)

In area franchises, a single development agreement is used to grant development rights for all outlets to be developed by the franchisee. Separate franchise agreements are then used to grant specific rights related to each outlet. Minority ownership of individual outlets (such as by outlet managers or passive investors) may be permitted.

Typically, area franchises are used for businesses that require a single franchise owner in a market to avoid encroachment and advertising problems that might otherwise arise if multiple owners develop a single market. Area franchises may also be attractive for businesses able to sustain a salary of an onsite manager, supervised by a franchisee owning multiple units. Given the management aspects of area franchise development, area franchisees should expect to have management experience and people skills.

VI. An Overview of the Law of Franchising

The franchise industry has been plagued by numerous cases of abuses and misrepresentations aimed at unsophisticated prospective franchisees. Widespread instances have been documented involving such malpractices as high pressure franchise sales tactics, unscrupulous and inexperienced franchisors, financially unstable franchisors, hidden fee requirements and kick-backs, failure to provide information on services and training to be furnished to the franchisee, and use of coercive methods to get quick large deposits. 43 Fed. Reg. 59,614, 59,625 (1978).

The response to the identification of such abuses in franchising was a wave of legislation designed to protect prospective franchisees from abuses connected with the offer and sale of franchises. The first piece of legislation generally regulating the sale of franchises was the California Franchise Investment Law (CFIL), which became effective on January 1, 1971. *See* Ca. Corp. Code 31000-31516 (West 1998). The California legislation was followed by action at the federal level in the form of an FTC Rule, and at the state level with enactments in nineteen jurisdiction, including: Alabama, Arkansas, Florida, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, Mississippi, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington, Wisconsin and the District of Columbia.

The FTC adopted its rule concerning Disclosure Requirements and Prohibitions Concerning Franchises and Business Opportunity Ventures, 16 C.F.R. 436 (1978) (hereinafter FTC Rule) pursuant to the Federal Trade Commission Act, 15 U.S.C.A. 41 (1984) (West 1974). The FTC Rule mandates that specified written disclosures be made at specified times and specified formats in connection with the offering and sale of franchises and business opportunities. 16 C.F.R. 436 n.1 (1978). While its status as a federal regulation would generally

cause the FTC Rule to preempt state and local legislation and regulations to the extent that such provisions are inconsistent with it, the FTC Rule itself notes that it does not preempt state laws providing protection equal to or greater than that afforded by the FTC Rule. 16 C.F.R. 436 n.2 (1978).

The advertising and selling of franchises is strictly regulated by both the Federal Trade Commission (FTC) and various state laws (*supra*). For example the FTC has minimum disclosure requirements, which detail the kind of information that must be disclosed to prospective franchisees. See J. T. McCarthy, *Trademarks and Unfair Competition* § 18:23 (2d ed. 1984). In some states, a violation of the state franchise disclosure law entitles the franchisee to rescind the agreement and recover royalties it has paid. *My Pie Int'l Inc. v. Debould, Inc.*, 687 F.2d 919, 220 USPQ 398 (7th Cir. 1982).

Tort Liability of Franchisor. Under various theories of tort and contract law, a franchisor generally will be held liable for the torts of franchisees. This includes legal responsibility for both personal injury and property damages resulting from defective products or negligently rendered services. See J. T. McCarthy, *Trademarks and Unfair Competition* § 18:24 (2d ed. 1984).

A. Before the modern franchising system developed, the courts tended to apply traditional principles of contract law to franchise contract issues, real property law to real property issues, and the like, without recognizing the unique character of the franchisor-franchisee relationship. However, as the franchising concept began to expand rapidly through the economy over the last three decades, so too did the case law. The number of judicial decisions directly involving business format or chain-style franchising problems increased

annually. Today, there is a recognized distinct body of law specifically dealing with the major concerns of the franchising industry and the franchising parties.[21]

B. Because an intellectual property license lies at the core of a franchise, the laws governing the licensing of intellectual property constitute the heart and arteries of franchise laws. Each of the four bodies of intellectual property law protects different property rights. Trademark law protects one's right to use a distinctive word, symbol, or other device to identify the "source" of goods or services and prevent confusion by competitors using similar words, symbols, or devices. Trade secrets law protects one's right to maintain secrecy and control the use of secret information that provides one company a competitive advantage over others. Copyright law protects an author's original expressions and the exclusive right to copy, display, distribute, perform, or use a work as the basis for derivative works. Patent law grants rights to inventors of new and useful machines, aesthetic designs, and useful methods of doing things. A patentee receives the right to exclude others from using his or her discovery without consent.[22]

C. The key challenge for the franchisor is to control who may use its intellectual property and to restrict that use in the franchise agreement to foster a uniform standard among the system's independently owned operations. Without this control in the license agreement, anyone would be able to use a franchisor's name, know-how, and creative works in any manner in derogation of the owner's intellectual property rights. Under those circumstances, franchisors would have little to license and entrepreneurs would have little incentive to develop franchise programs.[23]

1. Trademark Law

While all four kinds of intellectual property can be found in franchising, trademarks historically have ranked first in importance because of industry's heavy reliance on

manufacturing and distribution of goods.[24] Soft drink bottling, dating back to the late nineteenth century, was one of the earliest examples of franchising, followed by auto dealerships and gas station franchises. Franchisees facilitated the expansion of these franchise systems by investing their own funds and managing the local franchise businesses. In each case, the parent company owned the trademarks, provided the standards for uniformity throughout the system, and created a marketing image. As a result, "Coke," Pepsi," and "7Up" are bottled and sold throughout the world today by independent, franchised bottlers.[25]

a. Under the Lanham Act, a licensor must exercise quality control over the licensee or risk loss of the trademark.[26]

b. The Lanham Act does not immunize franchisors from the anti-trust laws.[27]

c. The Lanham Act does not contravene the protective measures adopted by many states such as in the prohibition of any termination or failure to renew a franchise except for "good cause."[28]

d. Because the term "quality" and its usual companion "uniformity" are claimed to condone subjective standards for the "control" required by the Lanham Act, the franchisor's discretionary control may create a fiduciary relationship.[29]

2. Trade Dress Law

The courts have held that a franchisor, like any business, has no protectable interest in the mere method and style of doing business. The functional elements of a business are not considered protectable against competition from others. In some cases, however, functional elements may be distinguished from the total image of a business, comprising its trade dress. Recent decisions of the Supreme Court and the courts of appeals grant more protection to

business methods. *State Street Bank and Trust Co. v. Signature Financial Group*, 149 F.3d 1368 (Fed. Cir. 1998). The same is true in protection afforded to the owner of trade dress. *Two Pesos, Inc. v. Taco Cabana Int'l Inc.* 505 U.S. 763 (1992) (9th Cir. 1987). For example, in 1978 a federal court refused to enjoin a franchisee from opening a restaurant that was "strikingly similar" to the franchisor's restaurant motif. *Fuddruckers, Inc. v. Doc's B.R. Others, Inc.* 826 F.2d 83. More recently, however, in factually similar circumstances, the courts have been willing to enjoin the use of similar restaurant motifs. The total image of a business may include the physical (geometrical) shape and appearance of a business, signage, choice of color, floor plan, decor, list of services or menu, choice of equipment, staff uniforms, and other features reflecting a total image (*Taco Cabana Int'l, Inc. v. Two Pesos, Inc.*, 932 F.2d 1113, 1118 (5th Cir. 1991), *aff'd.*, 505 U.S. 763 (1992). When these elements are viewed by a court as non-functional, either individually or in combination, they may be protected against use by someone else without the owner's consent. Moreover, even when some elements of a business's image are functional, if the particular combination of elements is not functional, that combination is also protected against appropriation by another. *Id.*

D. Disputes involving the use of intellectual property in a franchise relationship generally fall into one of two categories: (i) efforts to stop someone from using the franchisor's intellectual property or conversely, efforts by a franchisee or competitor to use that property; and (ii) a claim that the property was not used according to the franchisor's rules as stated in the license agreement. Trademark disputes generally test a franchisor's ability to require a franchisee to stop using a mark it was previously licensed to use. For example, the franchisor will seek to enjoin the continued use of a trademark by the (former) franchisee after the franchise agreement ends. This contrasts with trademark disputes outside the realm of franchising, which

typically involve questions about who owns a purported trademark or whether trademark rights have been established.[30]

E. Another example of a trademark dispute in the realm of franchise agreements exists where a party seeks to impose vicarious liability on franchisors for acts committed by the franchisees. Perhaps the most publicized example of this is the 1994 case against McDonald's Corp., in which a jury awarded a woman $2.9 million for burns suffered after spilling hot coffee in her lap.[31] More common than tort claims are actions seeking to hold franchisors liable for the acts of franchisees under the anti-discrimination laws. In *Neff v. American Dairy Queen Corp.*, 59 F.3d 1063 (5th Cir. 1995), *cert. denied*, 116 S. Ct. 704 (1996), the court refused to hold the franchisor liable for a franchisee's alleged failure to make its restaurant wheelchair accessible. The court stated that in order for the franchisor to be liable under the Americans With Disabilities Act ("ADA"), it would have to be considered the "operator" of the franchise. The critical factor in making this determination is control. A review of the franchise agreement established that the franchise was to be constructed in accordance with franchisor approved standards. Further, the franchisor retained the right to set building and equipment maintenance standards and to reject proposed structural changes. However, the court held that such control was insufficient to render the franchisor the operator for the purposes of the ADA. Because of discrepancies among the circuit courts' definition of "operator" and a dearth of case law on the subject, it is too early to tell what level of risk franchisors face under the ADA for wheelchair accessibility to a franchisee's building. Until such standards become clear, franchisors should carefully consider their core policies to assess whether they are potentially discriminatory or otherwise establish excessive control over terms and conditions of employment of the franchisee's employees and customer's access to the franchisee's operation.[32] This case is

explored in detail in *Dickinson Law Review*, Vol. 101:1, p. 137. The conclusion, as expressed by the author, is that the

> ". . . ADA's provisions do not solve the question of franchisor liability for Title III. If Congress does not amend the ADA and Neff becomes the guiding precedent of future Title III cases, persons with disabilities will need to wait even longer for the equality of access their representatives promised them when the ADA was passed. Persons with disabilities can still obtain their rightful access; they just have to sue each individual store or wait until each decides to remodel. The irony is that by refusing to recognize any liability on the part of franchisors, the Neff court may have disabled the ADA."

F. Disputes involving trade secrets usually test whether the franchisor owns a protectable trade secret. In other words, the question usually is whether the definitional elements of a trade secret are present, based on case or statutory law. The key issues in trade secrets involve the scope of the franchisor's know-how that is protected as a trade secret, the steps a franchisor must take to maintain secrecy, and the extent that a franchisor can enforce a covenant not to compete after the franchise ends.[33]

G. Copyright law has historically had a less significant impact on franchising in the courts. One commentator has stated that "the law of copyright is . . . of tangential interest to franchise systems."[34] However, most franchise systems include original expressions which may qualify for copyright protection. Additionally, copyright law may provide greater protection for creative assets than that which trademark or trade secret law may provide.[35]

H. Patent law has also been historically less significant to franchising. If there has been a key area of patent law issues for franchising, it has been issues that arise from licensing of patents, such as whether a franchisor seeking to enforce patent rights has properly used or misused its patent, and whether a franchisee's use of a licensed patent exceeded the scope of use authorized by the franchisor.[36]

I. The following case of misuse of advertising funds including a $600 million judgment was reported in the *New York Law Journal* (April 18, 1997). Franchise agreements entered into by Meineke with its franchisees, similar to many other franchise agreements, provided that each franchisee had to remit 10 percent of its weekly gross revenue to an advertising fund. The franchise agreements provided that these advertising contributions "shall be expended for advertising which is published, broadcast, displayed or otherwise disseminated either during the calendar year within which such funds are collected by Meineke, [or] during the immediately preceding or following calendar year." Five percent of the total advertising contribution was to be used for development and placement of national advertising; the remaining 95 percent of a franchisee's contribution was to be spent on advertising within the franchisee's locality or ADI (area of dominant influence). The court found that not only did Meineke use the profits of New Horizons for its benefit, but the court found that it used the fund to pay corporate expenses, purchase superfluous advertising for the sake of generating commissions, negotiate volume discounts from media while charging the full amount to the fund and use the fund to generate new franchisees. *Proussard v. Meineke Discount Muffler Shops, Inc.* 3:94CV 255-P (WDNC).

VII. What is a Franchise in Law?

A. Federal and state regulations now protect prospective franchisees by requiring disclosure and registration by franchisors, and a new Uniform Franchise and Business Opportunities Act as well as a Model Law have been proposed, but problems still persist with regard to such matters as the duty of good faith, earnings claims, and the introduction of random bills attempting to correct specific problems encountered by individual franchisees. (There is also an unresolved issue concerning attorney liability for due diligence in connection with

franchise offering circulars.) At the same time, there are significant economic changes, with the marketplace demanding greater levels of franchisor experience and financial strength, and the development of new forms of franchising, such as combination franchising and niche franchising.[37]

In Article 33, § 680 of the New York General Business Law, the legislative finding and declaration of policy with respect to the offer and sale of franchises is expressly set forth:

> 1. The legislature hereby finds and declares that the widespread sale of franchises is a relatively new form of business which has created numerous problems in New York. New York residents have suffered substantial losses where the franchisor or his representative has not provided full and complete information regarding the franchisor-franchisee relationship, the details of the contract between the franchisor and franchisee, the prior business experience of the franchisor, and other factors relevant to the franchise offered for sale.
>
> 2. It is hereby determined and declared that the offer and sale of franchises, as defined in this article, is a matter affected with a public interest and subject to the supervision of the state, for the purpose of providing prospective franchisees and potential franchise investors with material details of the franchise offering so that they may participate in the franchise system in a manner that may avoid detriment to the public interest and benefit the commerce and industry of the state. Further, it is the intent of this law to prohibit the sale of franchises where such sale would lead to fraud or a likelihood that the franchisor's promises would not be fulfilled.
>
> (Added L.1980, c. 730, § 1.)

The policy is set forth in §§ 681-695, which follow.

B. While a federal franchise relationship law of general application was proposed as early as 1971, no such law has ever been adopted at the federal level. Instead, the FTC issued its Rule on franchising, which became effective in 1979.[38] After an exhaustive study that began in 1971, the FTC determined that the most serious abuses by franchisors related to

misrepresentation and failure to disclose material facts. The remedy contained in the FTC Rule is presale disclosure. The FTC Rule does not require any federal filing or registration, nor does it regulate the relationship between franchisors and franchisees after the purchase of the franchise.[39]

C. The FTC Rule imposes six different requirements in connection with the "advertising, offering, licensing, contracting, sale or other promotion" of a franchise in or affecting commerce.

1. Basic Disclosures

The FTC Rule requires franchisors to give potential investors a basic disclosure document at the earlier of the first face-to-face meeting or ten business days before any money is paid or an agreement is signed in connection with the investment.[40]

2. Advertised Claims

The FTC Rule affects only advertisements that include an earnings claim. Such ads must disclose the number and percentage of existing franchisees who have achieved the claimed results, along with cautionary language. Their use triggers required compliance with the Rule's earnings claim disclosure requirements.[41]

3. Earnings Claims

If a franchisor makes earnings claims, whether historical or forecasted, they must have a reasonable basis, and prescribed substantiating disclosures must be given to a potential investor in writing at the same time as the basic disclosures.[42]

4. Franchise Agreements

The franchisor must give investors a copy of its standard-form franchise and related agreements at the same time as the basic disclosures, and final copies intended to be executed at least 5 business days before signing.[43]

5. Refunds

The FTC Rule requires franchisors to make refunds of deposits and initial payments to potential investors, subject to any conditions on refundability stated in the disclosure document.[44]

6. Contradictory Claims

While franchisors are free to provide investors with any promotional or other materials they wish, no written or oral claims may contradict information provided in a required disclosure.[45]

D. Failure to comply with any of the six requirements is a violation of the FTC Rule. "Franchisors" and "franchise brokers" are jointly and severally liable for the violation(s). Any person who sells a "franchise" covered by the FTC Rule is considered a "Franchisor" under the statute. Any person who "sells, offers for sale, or arranges for the sale" of a covered franchise is defined as a "franchise broker."[46]

The FTC can impose civil penalties of up to $10,000 per violation of the FTC Rule.[47] The FTC can also require rescission, reformation, payment of refunds or damages, or combinations of these remedies,[48] and it can issue cease-and-desist orders.

Currently, there is no private right of action for violations of the FTC Rule. Remedies do, however, exist under state law. State franchise and business opportunity laws, and state consumer fraud or "little FTC acts," which typically cover the sale of franchises and

frequently make any violation of the FTC Rule a state law violation, generally provide a private right of action for rescission, damages, costs and attorneys' fees, and sometimes multiple or punitive damages.[49] Willful violations of state laws may also result in criminal penalties, including fines and imprisonment.

VIII. State Registration and Disclosure Laws.[50]

A. Because disclosures required by state registration and disclosure laws can be used to satisfy the requirements of the FTC Rule, it is appropriate to review the state disclosure laws in connection with the FTC Rule. Sixteen states require franchisors to register and disseminate to prospective franchisees a prospectus type disclosure document prior to engaging in any franchise sales activity. These state registration and disclosure laws provide that, unless a statutory exemption is available, no offer or sale of a franchise can take place unless and until the franchisor has filed with the appropriate state agency — and that agency has approved and registered — a prospectus setting forth honestly and in detail all of the material facts of the franchise sales transaction. This registered prospectus must then be given to prospective franchisees at the earlier of: (i) the "first personal meeting" between a franchisor and its prospective franchisee (*i.e.* the first face-to-face meeting held for the purpose of discussing the sale, or possible sale, of a franchise); (ii) ten business days prior to the execution by the prospective franchisee of any franchise-related agreement; or, (iii) ten business days prior to the payment by the prospective franchisee of any monies or other consideration in connection with the sale, or proposed sale, of a franchise.[51] The most important exemption from the registration requirement is the "blue chip" exemption set forth in the CFIL section 31101, which is available to substantial franchisors who have been operating a minimum number of franchises for a specified period of time. In addition to the "blue chip" exemption in section 31101, there are

other exemptions provided in the body of the Franchise Investment Law, or that have been promulgated by the Commissioner of the Department of Corporations pursuant to rule making powers of section 31100 which explicitly grant to the Commissioner the power to exempt "any other transaction which the Commissioner by rule exempts as not being comprehended within the purposes of this law and the registration of which the Commissioner finds is not necessary or appropriate in the public interest for the protection of investors." Cal. Corp. Code 31110 (West 1997). Among the exemptions set forth in the CFIL and the correlate regulations are exemptions for the sale of a franchise or area franchise by a franchisee or subfranchisor on their own account, *id.* 31102 (West 1997), certain transfers of franchises to persons outside the state of California, *id.* 31105 (West 1997), certain offers, sales or transfers of franchises involving the wholesale distribution or marketing of petroleum products, *id.* 31104 (West 1997), or involving franchisees possessing certain levels of experience and sophistication, *id.* 31106 (West 1997), transactions relating to "bank credit card plans," *id.* 31103 (West 1997), transactions in which the franchise fee is no more than $100, Cal. Code Regs. tit. 10, 310.011, or the amounts paid for fixtures, equipment and the like are no more than $1,000 annually, as long as those amounts are not more than comparable wholesale prices, *id.* 310.011.1 (West 1998). The state laws also contain significant criminal penalties. It allows district attorneys to prosecute certain violations. Section 31410 of the CFIL states that a party found guilty of a willful violation of "any provision" or of "any rule or order under" the CFIL can be fined up to $10,000, imprisoned for up to a year, or both, unless the party can establish that he or she had no knowledge of the rule or order violated.

The disclosure and registration requirements of New York are extensive, and strict compliance is required. § 687 sets forth the practices which will be found unlawful:

1. It is unlawful for any person to make any untrue statement of a material fact in any application, notice, statement, prospectus or report filed with the department under this article, or wilfully to omit to state in any such application, notice, statement, prospectus or report any material fact which is required to be stated therein, or to fail to notify the department of any material change as required by this article.

2. It is unlawful for a person, in connection with the offer, sale or purchase of any franchise, to directly or indirectly:

(a) Employ any device, scheme, or artifice to defraud.

(b) Make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. It is an affirmative defense to one accused of omitting to state such a material fact that said omission was not an intentional act.

(c) Engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

3. It is unlawful for any person to violate any provision of this article, or any rule of the department promulgated hereunder, or any condition to the effectiveness of the registration of an offering prospectus or of an exemption from the registration provisions of this article.

4. Any condition, stipulation, or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law, or rule promulgated hereunder, shall be void.

5. It is unlawful to require a franchisee to assent to a release, assignment, novation, waiver or estoppel which would relieve a person from any duty or liability imposed by this article.

The department of law (§ 689) is empowered to bring an action in the name of the people of the State of New York against any person concerned or in any way participating in any of the enumerated unlawful or fraudulent practices and for injunction and other relief as may be indicated.

IX. Franchise Relationship Laws[52]

A. Sixteen states, Puerto Rico and the District of Colombia have adopted franchise relationship laws since California passed the California Franchise Investment Law in 1971.[53] While each state relationship law has a different definition for the term "franchise," most definitions have a combination of the following elements: (i) either a marketing plan or community of interest element; (ii) a trademark element; and (iii) a fee element.

1. Marketing Plan

The term "marketing plan" refers to a grant of the right to engage in business under a marketing plan or system prescribed in substantial part by the franchisor. Generally, a marketing plan exists whenever the franchisor presents the group of franchised outlets to the public as a unit, with the appearance of some centralized management and uniform standards. Under the California state law, a franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed by the franchisor and the operation is substantially associated with the franchisor's trademark, service mark, trade name, logo, advertising or other commercial symbol and the franchisee is required to pay a franchise fee. In Illinois, the Franchise Disclosure Act provides that a marketing plan means a plan or system relating to some aspect of the conduct of a party to a contract in conducting business, including but not limited to (a) specification of price, or special pricing systems or discount plans, (b) use of particular sales or display equipment or merchandising devices, (c) use of specific sales techniques, (d) use of advertising or promotional materials or cooperation in advertising efforts. The marketing plan approach in defining what constitutes a franchise has been adopted by a majority of the states, including California, and the FTC.

2. Community of Interest

This approach has been adopted by a few states, including New Jersey and Wisconsin. Some of the franchise laws require that a franchisor and franchisee maintain a "community of interest" in the marketing of the goods or services. This is usually a much broader element than the marketing plan. In Wisconsin, for example, a community of interest exists where the parties have a continuing financial interest and a degree of interdependence. This broad definition can refer to almost any on-going business relationship in which the dealer has an investment in the business.[54] In New Jersey, on the other hand, the courts have construed "community of interest" more narrowly and require the franchisor to maintain a higher degree of control. In effect, this means that there must be a sufficient inequality between the parties such that termination of the relationship by the stronger party would shock the court's sense of equity.[55]

Under the "community of interest" approach, an agreement is considered to be a franchise where: (1) the franchisee is granted a right to engage in business using the franchisor's proprietary marks or property; (2) a community of interest exists concerning the marketing of the goods or services of the business; (3) the franchisee is required to pay a franchise fee of some sort. Due to the fact that the phrase "community of interest" is generally taken to mean simply a continuing financial interest between parties, the likelihood that a particular business arrangement might fall under such a definition is relatively strong. Therefore, "community of interest"-type definitions tend to be regarded as, potentially, quite broad.

By contrast, the "marketing plan" definition provides a narrower focus. Under this approach, a business arrangement will be found to be a franchise if: (1) the franchisee is granted the right to operate a business involving a marketing plan or system substantially

prescribed by the franchisor; (2) the franchised business is substantially associated with the proprietary marks or property of the franchisor; and (3) the franchisee is required to pay a franchise fee of some sort.

Broken down into its component parts, the definition of franchise (marketing plan) consists of four conjoined elements: (1) the franchisee must be granted by the franchisor the right to engage in the business of offering, selling or distributing goods or services; (2) that business must be operated pursuant to a marketing plan or system prescribed in substantial part by the franchisor; (3) that business must also be substantially associated with the franchisor's proprietary marks; and (4) the franchisee must have to pay, directly or indirectly, a franchise fee.

3. Trademark

The trademark element of the state relationship laws will always be satisfied if the franchisee is licensed to do business under the franchisor's name or mark. Most of the marketing plan franchise laws, however, do not require a license. In some of these states, the operation of the franchisee's business must be "substantially associated" with the franchisor's trademark. In other states, the trademark element is satisfied where the franchisor's trademark or service mark identifies the goods or services sold, rather than the business itself. This would include many ordinary distributorships.[56]

4. Fee

The fee element of the definition of a franchise generally means any fee or charge that the franchisee is required to pay for the right to do business under the franchise agreement. This payment does *not* have to be in the form of a franchise fee; it may also be royalties on sales. As a result, almost any trademark license agreement would satisfy this requirement. It may be, for example, a required payment for rent, advertising assistance, equipment and supplies.

However, it does *not* include payment for a reasonable quantity of goods for resale at a *bona fide* wholesale price.[57] For example, in *Brawley Distribution Co. v. Polaris Indus.*, the Minnesota District Court held that minimum purchase requirements, required fees for advertising and training and to process warranty work, and a charge of fifty percent over the suggested sale price did not constitute franchise fees.[58] The payment of a fee by the franchisee signals that the franchisee is buying something of value from the franchisor: the grant of a right to engage in a business which includes the right to use the franchisor's marketing plan, and a license to use the franchisor's commercial symbols. In this regard, then, a franchisee occupies a very different status from that of an employee, agent or other similar business entity. The franchisee, rather than being compensated by the employer or principal in exchange for services, purchases — by means of the franchise fee — from the franchisor the right to own and operate his or her own business using the franchisor's business expertise and commercial symbols.

X. The Uniform Franchise Offering Circular ("UFOC")

A. As franchising continued to expand in the 1980s as a method of doing business, litigation involving franchising also continued to increase. The result is that the rights and obligations of the parties to franchise agreements under state relationship laws and under the common law were greatly clarified. Relatively little new franchise legislation was enacted during the 1980s, although many bills were introduced during this decade both at the state and federal levels. Instead, there was a legislative reaction to the patchwork of inconsistent state legislation enacted in the 1970s. In 1983, the National Conference of Commissioners on Uniform State Laws ("NCCUSL"), author of the Uniform Commercial Code ("UCC"), undertook the creation of a basis for uniformity among the state franchise laws. The NCCUSL approved the final version of the Uniform Franchise and Business Opportunities Act ("UFBOA")

in 1987.[59] The Act requires a simple notice filing with the appropriate state agency in connection with franchise sales and includes a private cause of action for violation of the Act, which does not exist for violation of the FTC Rule. In the area of franchise relationships, the Act codifies the common law covenant of good faith and fair dealing, rather than mandating good cause and procedural requirements similar to those contained in a number of existing state franchise relationship laws. Passage of the Act by those states that have franchise laws would go a long way toward eliminating the inconsistencies in franchise regulation and reducing the high cost of compliance for franchisors.[60]

B. Unfortunately, the NCCUSL is unlikely to enjoy the success in the field of franchising that it achieved in the field of commercial law with the UCC. On April 25, 1993, the NASAA membership voted unanimously to adopt the New UFOC Guidelines. The phase-in adopted by NASAA provides that the New UFOC guidelines are effective six months after the FTC and each NASAA member whose jurisdiction requires presale registration of a franchise adopts the New UFOC. New York was the last state to adopt the New UFOC. As of January 1, 1996, all initial franchise applications and renewals must comply with the New UFOC.[61]

XI. Recent Administrative Developments

A. Following years of study, hearings and submissions, the FTC is about to conduct the first wholesale revision of its FTC Franchise Rule since its adoption nearly 20 years ago. In an Advance Notice of Proposed Rulemaking ("ANPR") published in the Federal Register, the FTC reveals its plans for revising the Rule and addresses a number of issues of critical concern to franchisors and franchisees alike. The FTC has no interest in applying the FTC Franchise Rule to international transactions involving American franchisors.[62] Accordingly, significant relief may be granted to franchisors when they need to comply with the FTC Franchise Rule

when selling franchises abroad. At the same time, the FTC has hinted that it may impose new disclosure requirements in connection with the sale of "co-branded" franchises (in which two or more franchisors combine forces to offer a franchisee the opportunity to operate two or more trademarked franchises in one outlet). The ANPR notes that the FTC "is uncertain whether the (co-branded) franchisee is purchasing two individually trademarked franchises (and thus should receive separate disclosures from each franchisor) or is purchasing a hybrid franchise arrangement that has its own risks (and thus should receive a single unified disclosure document)."

B. Further, the FTC is exploring whether its Franchise Rule should be modified to embrace franchise sales activity taking place over the Internet and through other electronic communication modes. Similarly, the FTC suggests in the ANPR that the "first personal meeting" language of the Franchise Rule's requirement may be replaced by a "first substantive discussion" disclosure requirement for disseminating disclosure documents. This "discussion" may take place over the internet, the telephone or through other electronic means.

C. The most substantive potential changes are related to the mandatory disclosure requirements. The ANPR suggests that the FTC might mandate franchisors set forth earnings claim disclosures in their disclosure documents.[63] On the other hand, the FTC appears ready to require franchisors to set forth prominently in their disclosure documents that the FTC Franchise Rule permits a franchisor to provide a prospective franchisee with earnings claim information and that if such information is not set forth in the franchisor's disclosure document, no other earnings claim information imparted should be relied upon absent written substantiation. Further, the ANPR clearly states that the Commission is seriously considering "whether it should revise the Rule's disclosures based on the UFOC guidelines." In other words, the day of two

disclosure formats — the FTC Franchise Rule format and the UFOC model — appears to be drawing to a close. However, it is clear that should the FTC adopt the UFOC guidelines, those UFOC guidelines may be revised to correct certain perceived deficiencies (including, inter alia, the possible mandated disclosure of lawsuits commenced by franchisors against their franchisees).[64]

XII. Antitrust

In the early 1970s, the federal antitrust laws, as then interpreted and applied by the courts, provided a powerful basis for claims against franchisors. The antitrust laws provide in many circumstances for treble damages as well as attorneys' fee awards. At that time, the legality of vertical restrictions was in doubt. In practice, many franchisors were engaging in tying practices. Many franchisees were forced to buy equipment from the franchisor or its affiliates when there were perfectly acceptable alternative sources of supply.

As a result of changes in practices in the industry and changes in the attitudes of regulatory and judicial officials toward antitrust laws, claims of antitrust violations dropped off significantly in the 1980s. Antitrust laws today are used by franchisees only in the more egregious cases.

XIII. Conclusion

As is clear from the foregoing paper, the concept of franchising has taken hold and exploded so exponentially that its permanency on the American landscape can no longer be questioned.

As a useful warning to practitioners counseling actual and potential franchisors and franchisees, a lesson to be learned is that a failure to properly appreciate the concept of a franchise underlying the definition in section 31005(a) of the CFIL (see also the New York

General Business Law § 681) can result in an indiscriminate and unwarranted application of the state statutes that have adopted that statute as well as the FTC. To this end, this Article has sought to show that the concept of "franchise" encompassed by the four elements contained in the marketing definition in section 31005(a) of the CFIL embodies a specific blend of independence and dependence.

A franchise is a relationship in which the franchisee is independent by virtue of the fact that the franchisee is granted the right by the franchisor to actually own and operate the franchise business. As a result, the franchisee is the one who actually runs the business and bears the risk if it is not successful. At the same time, the franchisee is singularly dependent upon the franchisor due to the fact that the success of the business largely depends upon the franchisor's expertise, in the form of the method of operation provided by the franchisor, and the franchisor's commercial identity, in the form of the franchisor's symbols. Indeed, it is the grant of the right to engage in business using the franchisor's method of operation and commercial symbols for which a franchisee pays a franchise fee. Without this unique blend of independence and dependence, there simply is not a franchise. Absent an appreciation of the conceptual basis of the definition of "franchise", the courts may well continue improperly to transform into franchises traditional forms of business enterprises, which do not, in fact, possess the necessary blend of independence and dependence.

ENDNOTES

[1] David J. Kaufmann, *An Introduction to Franchising and Franchise Law, Franchising 1992, Business and Legal Issues*, 12 Practicing Law Institute Commercial Law and Practice Course Handbook Series 603 (1992).

[2] Harold Brown, *Franchising, Realities and Remedies*, § 1.03[1] (Law Journal Seminars-Press 1997). Martin D. Fern, *The Overbroad Scope of Franchise Regulation: A Definitional Dilemma*, 3rd Bus. Law. 1387 (1979).

[3] This definition was devised by commentator Harold Brown and was substantially adopted in a number of states.

Connecticut: Conn. Gen. Stat. Ann § 42-133e(b).

New Jersey: N.J. Stat. Ann. § 35.6-1.

Washington: Wash. Rev. Code § 252.1.

[4] Brown, *supra* at § 103[3].

[5] Kaufmann, *supra* at 12.

[6] Kaufmann, *supra* at 13.

[7] "Franchising in the Economy 1986-87," U.S. Dept. of Commerce 1988 *cited in* Brown, *supra* at § 1.01[l]. S. J. Kelly, Small Business Forum; *Is Your Future In Franchises? Assess the Opportunity and Risk*, L.A. Times, June 3, 1998, at D7. International Franchise Association, Industry and Trade Summary on Franchising (1995).

[8] Brown, *supra* at § 1.02[2].

[9] Kaufmann, *supra* at 19.

[10] Brown, *supra* at § 1.02[2].

[11] Brown, *supra* at § 1.02[2].

[12] Brown, *supra* at § 1.02[3].

[13] Brown, *supra* at § 1.02[1].

[14] Brown, *supra* at § 1.02[2]

[15] Brown, *supra* at § 3.02[1]

[16] Kaufmann, *supra* at 24.

[17] Kaufmann, *supra* at 26.

[18] Kaufmann, *supra* at 27.

[19] Kaufmann, *supra* at 27.

[20] Kaufmann, *supra* at 29.

[21] Lowell, *Sources and Trends for Franchise Law in the Eighties (Part 3)*, 2 Franchise L.J. 30, Spring 1983; Leet, *Sources and Trends for Franchise Law in the Eighties (Part 4)*, 5 Franchise L.J. 15, Fall 1985; Lowell, *Time Travel: Franchise Relationships of Tomorrow*, American Bar Association 11th Annual Forum on Franchising (1988). Cited in 62B Am. Jur. 2d Private Franchise Contracts § 6 (1990).

[22] David Gurnick, *A Symposium on Franchise Law: Intellectual Property in Franchising: A Survey of Today's Domestic Issues*, 20 Okla. City U.L. Rev. 347 (1995).

[23] Gurnick, *supra* at 351.

[24] See e.g., *Susser v. Carvel Corp.*, 206 F. Supp. 636, 640 (S.D.N.Y. 1962), *aff'd.* 332 F.2d 505 (2d Cir. 1964), cert. dismissed, 381 U.S. 125 (1965) (stating that the trademark is the cornerstone of a franchise system. See also 2 J. Thomas McCarthy, *McCarthy on Trademarks and Unfair Competition* § 18.22 (3d ed. 1992) ("In some situations, a franchise is merely a sophisticated program of trademark

licensing.") cited in David Gurnick, A Symposium on Franchise Law: Article: *Intellectual Property in Franchising: A Survey of Today's Domestic Issues*, 20 Okla. City U.L. Rev. 347, *351.

[25] Franchised automobile and truck dealers, gasoline service stations, and soft drink bottlers together accounted for an estimated 70% of all sales by franchises in the U.S. in 1988. Thomas M. Pitegoff, *Franchise Relationship Laws: A Minefield for Franchisors*, 45 Bus. Law.

[26] 15 U.S.C. §§ 1055, 1064(e)(1), 1127.

[27] 15 U.S.C.§ 115(b)(7).

[28] *See also Mariniello v. Shell Oil Co.*, 511 F.2d 853 (3rd Cir. 1975).

[29] *Domed Stadium Hotel, Inc. v. Holiday Inns, Inc.*, 732 F.2d 480 (5th Cir. 1984); *Bain v. Champlin Petroleum Co.*, 692 F.2d 43 (8th Cir. 1982); *Arnott v. American Oil Co.*, 609 F.2d 873 (8th Cir. 1979), *cert. denied* 446 U.S. 918 (1980).

[30] Gurnick, *supra* at 353.

[31] *See, e.g.* "McDonald's Settles Out of Court Over Coffee Burns," *Leg. Intelligencer*, Dec. 5, 1994, at 4. A judge later reduced the award by more than $2 million. Ultimately, the case was settled for an undisclosed amount. *Id.*

[32] Jeffrey S. Klein and Nicholas J. Pappas, *A Franchisor's Liability For Discrimination by Franchisees*, 6/3/96 N.Y.L.J. 3, (col. 1).

[33] Gurnick, *supra* at 352.

[34] W. Michael Garner, *Franchise and Distribution Law and Practice* § 7.47 (1990).

[35] Gurnick, *supra* at 353.

[36] *See e.g.* Span-Deck, Inc. V. Fab-Con, Inc. 677 F.2d 1237 (8th Cir. 1982), *cert. denied,* 459 U.S. 981 (1982); *R & G Affiliates, Inc. v. Knoll Intl.,* Bus. Franchise Guide (CCH) ¶ 8181 (S.D.N.Y. 1984).

[37] 62B Am. Jur. 2d, *supra.*

[38] Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, 16 C.F.R. 436 (1979).

[39] Pitegoff, *supra* at *4.

[40] Lydia B. Parries, Federal Trade Commission Regulation of Franchising, 12 Practicing law Institute Commercial Law and Practice Course Handbook Series 603, 102 (1982).

[41] Parnes, *id.*

[42] Parnes, *id.*

[43] Parnes, *id.*

[44] Parnes, *id.*

[45] Parnes, *id.*

[46] Lydia B. Parries, *Federal Trade Commission Regulation of Franchising,* 12 Practicing Law Institute Commercial Law and Practice Course Handbook Series 603, 102 (1982).

[47] 15 U.S.C. § 45(m)(1).

[48] 15 U.S.C § 57(b).

[49] *Selliner* v. *Freeway Mobile Homes Sales, Inc.*, 110 Ariz. 573, 521 P. 2d 1119 (1974).

[50] STATE FRANCHISE DISCLOSURE LAW CITATIONS

California: Cal. Corp. Code, Ch. 10 §§ 310 *et seq.*

Florida: Fla. Stat. Ann., Ch. 71-61; see also Florida Rules, Ch. 2-17.

Hawaii: Hawaii Rev. L. § 482E-1.

Illinois: Ill. Ann. Stat., Ch. 121, § 701 Indiana: Ind. Code § 2.5.23-1.

Massachusetts: Mass. Gen. L. Ann., Ch. 93A § 2(a), (b).

Michigan: Mich. Comp. L. § 19.854, later amended to prescribe disclosure without prior registration.

Minnesota: Minn. Stat. Ann. § 800.01.

New York: N.Y. Gen. Bus. L. §§ 680-695.

North Dakota: Senate Bill No. 2479 (1975).

Oregon: Ore. Rev. Stat. § 650.007; see also, Oregon Rule § 40-050.

Rhode Island: R.I. Rev. L. Ann. § 19-28-1.

South Dakota: S.D. Comp. L. § 37-5A-1.

Virginia: Va. Code Ann. § 13.1-557.

Washington: Wash. Rev. Code § 19.100.010.

Wisconsin: Wis. Stat. Ann. § 553.10; see also, Wis. Adm. Code § 31.01.

[51] Kaufman, *supra* at 50.

[52] FRANCHISE RELATIONSHIP LAW CITATIONS AND POPULAR NAMES

Franchise Practices Act, Ark. Stat. Ann. §§4-72-201 to -210 (1987).

California Franchise Relations Act, Cal. Bus. & Prof. Code §§ 20000 to 20043 (West 1981).

Trading Stamps, Mail Order, Franchises, Credit Programs, Subscriptions Act, Conn. Gen.

Stat Ann. §§ 42-133e to -133h (1972).

Delaware Franchise Security Law, Del. Code Ann. tit. 6 §§ 2551 to 2556 (1953).

Franchising Act., D.C. Code Ann. §§ 29-1201 to -1208 (1989).

Franchise Investment Act, Hawaii Rev. Stat. § 482-E6 (1978).

Franchise Disclosure Act, III. Rev. Stat. ch. 121 1/2 ¶ 1718-20 (1988).

Deceptive Franchise Practices Act, Ind. Code Ann. § 23-2-2.7-1 (1987).

Franchise Investment Law Act, Mich. Comp. Laws § 445.1527 (West 1984).

Franchise Act, Minn. Stat. § 80C.14 (1986).

Pyramid Sales Scheme Act, Miss. Code Ann. § 75-24-53 (1975).

Pyramid Sales Scheme Act., Mo. Rev. Stat. §§ 407.400 to .420 (1975).

Franchise Practices Act, Neb. Rev. Stat. §§ 87-401 to -410 (1978).

Franchise Practices Act, N.J. Rev. Stat. §§ 56:10-1 to :10-12 (1971).

Retail Franchising Act, Va. Code Ann. § 13.1-557 (1972).

Franchise Investment Protection Act, Wash. Rev. Code §§ 19.100.180, .190 (1980).

Fair Dealership Law, Wis. Stat. §§ 135.01 to .07 (1985).

Dealer's Act, P.R. Laws Ann. tit. 10, § 14-278 (1964).

V.I. Code Ann. tit 12A §§ 2-130 to -139 (1979).

[53] The California Franchise Investment Law requires franchisors to register and disseminate to prospective franchisees a prospectus-type disclosure document prior to engaging in any franchise sales activity. California Corporations Code, Div. 5, Parts 1-6, Sections 3100 *et seq.*

[54] Wis. Stat § 135.02(3) (1985).

[55] *New Jersey Am., Inc.* v. *The Allied Corp.*, Bus. Franchise Guide (CCH) P9395 (3d Cir. 1989); *Colt Indus.* v. *Fidelco Pump & Compressor Corp.*, Bus. Franchise Guide (CCH) P9095 (3rd Cir. 1988).

[56] For discussions of the trademark requirement, see *Colt Indus.*, Bus. Franchise Guide (CCH) P9095 (New Jersey); *American Business Interiors, Inc.* v. *Haworth, Inc.*, 798 F.2d 1135, 1140 (8th Cir. 1988).

[57] Cases discussing the fee requirement include *inter alia Boat & Motor Mart* v. *Sea Ray Boats, Inc.*, 825 F. 2d 1285 (9th Cir. 1987) (California Law); *Cambee's Furniture* v. *Doughboy Recreational,* 825 F. 2d 167 (8th Cir. 1987) (South Dakota law); *Inland Printing Co.* v. *A.B. Dick Co.*, Bus. Franchise Guide (CCH) P8997 (W.D. Mo. 1987) (Illinois law); *American Parts System* v. *T & T Automotive,* 358 N. W. 2d 674 (Minn. Ct. App. 1984) (Minnesota law).

[58] Pitegoff, *supra* at *8.

[59] Bus. Franchise Guide (CCH) P3600 [hereinafter Act].

[60] Pitegoff, *supra* at *5.

[61] Bus. Franchise Guide (CCH § 5901).

[62] "The Rule Review record strongly supports modification of the Rule to clarify that international franchise sales are not within its purview."

[63] "The Rule Review record . . . does not support the view that a franchisor's failure to provide earnings information is necessarily deceptive or unfair . . . [The] record indicates that prospective franchisees can obtain earnings information from other sources . . . . Moreover, the . . . record does not provide a sufficient basis for the Commission to formulate an earnings disclosure that would be both useful and not misleading to prospective franchisees."

[64] David J. Kaufmann, *FTC Revamps Franchise Rule,* 4/24/97 NYLJ 3, (col. 1).