Will Your Trademark License Become an Inadvertent Franchise?

By: Dennis Steinman, Esq.[1]

I. Introduction

For decades, the franchise model has been a useful tool for businesses to expand their concept, and for franchisees to take advantage of a prepackaged method without starting from scratch. Trademarks and trade names are generally the cornerstones of the franchise system. However, unsuspecting practitioners may create a franchise relationship through trademark licensing. Franchise laws are onerous, and attorneys should be careful not to subject their clients to these laws inadvertently.

a. Federal Franchise Definition of Franchise

After a wave of fraud and abuse complaints in the 1960s and 70s, the Federal Trade Commission (FTC) promulgated a rule to police franchises on the federal level.[2] The Franchising and Business Opportunity Ventures Trade Regulation Rule[3] aims to protect franchisees from the deceptive business practices that were rampant prior to its promulgation in 1978.[4] The rule was revised in 2007 (Amended FTC Rule) and the FTC issued a Franchise Rule Compliance Guide in 2008 to assist franchisors in complying with the amended rule.[5] Under the Amended FTC Rule, a franchise is defined as:

> [A]ny continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:
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> (1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark [The Trademark License Element];
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> (2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation [The Control Element]; and

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[2] Mark H. Miller, *Unintentional Franchising*, 36 ST. MARY'S L.J. 301, 304 (2005).
[3] Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, 16 C.F.R. 436.1 (1979) (codifying 43 Fed. Reg. 59,614 (Dec. 21, 1978)).
[4] Miller, *supra* note 2, at 304.
[5] *FTC Franchise Rule Compliance Guide*, F.T.C. (May 2008), https://www.ftc.gov/tips-advice/business-center/guidance/franchise-rule-compliance-guide.

> (3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate [The Payment Element].[6]

If all three elements of the rule are present, then the business relationship will be deemed a franchise. The new rule affirmed prior case law in two regards: first, regardless of the labels parties use, if the elements are met, the relationship is a franchise; second, if the franchisor represents that the relationship being offered to the franchisee has the characteristics of a franchise, the relationship will be deemed a franchise, even if the franchisor doesn't perform as promised.[7] The amended FTC Rule regulates franchise sales in all 50 states, and even wholly intrastate transactions.[8]

The Trademark License Element.[9] Under the Amended FTC Rule, a trademark is a broadly applied term, intended to cover not only trademarks, but "any service mark, trade name, or other advertising or commercial symbol."[10] To meet this element, the franchisor does not have to own the trademark, but must at least have the right to license the use of the mark to others, which is integral to franchising.[11] For example, a supplier could avoid the application of this element by expressly prohibiting a distributor from using its mark in a distribution arrangement.[12]

The Control Element.[13] This element weighs the franchisor's control and assistance to the franchisee, and the more the franchisee relies on a franchisor's control and assistance, the more likely it will be considered significant.[14] This is likely to occur when a franchisee is inexperienced in the business being offered, or when a franchisee takes a large financial risk in the business relationship being offered.[15] Control or assistance will be significant only when it relates to the overall method of operation, not just a small or marginal part of the business.[16] The FTC suggests the following examples are significant types of control:

- site approval for unestablished businesses;
- site design or appearance requirements;
- hours of operation; production techniques;
- accounting practices; personnel policies;
- promotional campaigns requiring franchisee participation or financial contribution;

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[6] 16 C.F.R. 436.1(h) (2007).
[7] Kenneth R. Costello, Beata Krakus and Kristy L. Zastrow, *From License Agreement to Regulated Relationships: the Accidental Franchise*, AMERICAN BAR ASSOCIATION 32ND ANNUAL FORUM ON FRANCHISING, 3 (2009), hosted by GREENSFELDER, HEMKER & GALE, P.C. at https://www.greensfelder.com/media/event/112_KrakusPresentation_TheAccidentalFranchise.pdf (last visited Feb. 5, 2018).
[8] Rochelle Spandorf, *Structuring Licenses to Avoid the Inadvertent Franchise*, 2 LANDSLIDE 37, 37 (2010).
[9] 16 C.F.R. 436.1(h)(1) (2007).
[10] FTC Franchise Rule Compliance Guide, *supra* note 5, at 2.
[11] *Id*.
[12] *Id*.
[13] 16 C.F.R. 436.1 (h)(2) (2007).
[14] FTC Franchise Rule Compliance Guide, *supra* note 5, at 2.
[15] *Id*.
[16] *Id*. at 2–3.

- restrictions on customers; and
- locale or area of operation.[17]

The FTC lists the following as examples of significant assistance:

- formal sales, repair, or business training programs;
- establishing accounting systems;
- furnishing management, marketing, or personnel advice;
- selecting site locations;
- furnishing system-wide networks and website; and
- furnishing a detailed operating manual.[18]

The FTC relies on four factors when determining whether significant control or assistance is present: (1) a requirement that a franchisee service or repair a product (except warranty work); (2) inventory controls; (3) required displays of goods; and (4) on-the-job assistance with sales or repairs.[19] Providing media advertising on mediums like television and radio is also covered by this element.[20] However, the FTC has also identified several types of activities that do not constitute significant assistance or control, including promotional activities without additional forms of assistance i.e. furnishing point-of-sale advertising displays, sales kits, product samples, and other promotional materials.[21] As a matter of FTC policy, the following activities are not considered significant control or assistance:

- trademark controls designed solely to protect the trademark owner's legal ownership rights in the mark under state or federal trademark laws (such as display of the mark or right of inspection);
- health or safety restrictions required by federal or state law or regulations;
- agreements between a bank credit interchange organization and retailers or member banks for the provision of credit cards or credit services; and
- assisting distributors in obtaining financing to be able to transact business.

This element is the most likely of the three to inadvertently establish a franchise relationship, because practitioners may fail to recognize the application of this element. Attorneys should carefully examine any level of control or assistance in relationships that might be deemed a franchise, and confirm that the level of control is both necessary and limited to maintaining the quality of the trademark being licensed.

The Payment Element.[22] Like the term "trademark," "payment" is intended to be applied broadly to capture all sources of revenue a franchisee is required to pay a franchisor or an affiliate, for the right to associate with the franchisor, to market its goods or services, and to

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[17] *Id*. at 3.
[18] *Id*.
[19] *Id*. at 3–4.
[20] *Id*. at 4.
[21] *Id*. at 4.
[22] 16 C.F.R. 436.1 (h)(3) (2007).

begin operating the business.[23] Required payments of at least $500 at any time prior to or within the first six months of operations are included in this element.[24] Payment types covered under this element include:

- initial franchise fee;
- rent;
- advertising assistance;
- equipment and supplies (including such purchases from third parties if the franchisor or its affiliate receives payment as a result of the purchase);
- training;
- security deposits;
- escrow deposits;
- non-refundable bookkeeping charges;
- promotional literature;
- equipment rental; and
- continuing royalties on sales.[25]

This element emphasizes the mandatory nature of payments made to the franchisor, and will even encompass payments for things like a charge for equipment that can only be purchased from the franchisor or an affiliate, that is not available from any other source.[26] The FTC has specified that payments to purchase inventory for resale or lease in "reasonable amounts" and "at bona fide wholesale prices" are not included under this element.[27] "Reasonable amounts" of inventory means amounts that are not "in excess of those that a reasonable businessperson normally would purchase for starting inventory or supply, or to maintain an ongoing inventory or supply."[28] Included are goods intended to be leased to the public, such as leased automobiles or furniture rentals.[29] This "inventory exception" however does not include goods that a franchisee must purchase for its own operation of the business, like equipment or ordinary business supplies.[30] Lastly, because franchise laws are not waivable, a licensor may not be able to revert back to non-franchise status, even if the licensor offers to refund payments already made by the franchisee.[31] Consequently, a licensor avoiding franchisor status may not achieve maximized profits.

b. Exemptions and Exclusions under the Amended FTC Rule

There are several exemptions under the Amended FTC rule that prevent certain franchise

[23] FTC Franchise Rule Compliance Guide, *supra* note 5, at 5.
[24] *Id*. at 4–5.
[25] *Id*.
[26] *Id*. at 5–6.
[27] *Id*. at 6.
[28] *Id*.
[29] *Id*.
[30] *Id*.
[31] Spandorf, *supra* note 8, at 41.

relationships from being regulated under the rule.[32] These exemptions may be relevant based on the circumstances of the business relationship being offered, and practitioners should examine them carefully to determine whether an exemption applies. Similarly, certain relationships are excluded from the Amended FTC Rule, including the employer-employee, general partner, cooperative associations, certification or testing services and single trademark license relationships.[33] The single trademark license exclusion is most relevant to our discussion. This exclusion narrowly includes a single licensee that is granted the right to use a trademark. A one-to-one licensing arrangement is also included in the exclusion (a single trademark licensee manufactures the trademarked goods to the licensor's specifications, an arrangement common in the clothing industry).[34] Additionally, collateral product licensing (licensing a trademark well-known in one context, like a soft drink logo, for use in another context, like on clothing embossed with the soft drink logo) and licensing agreements entered into during trademark infringement settlement negotiations are excluded.[35]

c. State Franchise Regulation

The Amended FTC Rule does not preempt the states from creating their own more restrictive regulations, and roughly 25 states have issued their own laws relating in some way to franchises, often labeling the laws as regulating the sale of "business opportunities."[36] Practitioners should consider both the federal and applicable state franchising laws when determining whether a relationship will be deemed a franchise. While a relationship may not meet the federal definition, the same relationship may be deemed a franchise under a more restrictive state law. State laws may have the same or similar federal disclosure requirements described below, but may also require the disclosure document to be registered with the state. Again, state laws vary widely, and will depend on the jurisdiction applicable in each individual case. A close examination of all state franchise sales and relationship laws is beyond the scope of this article.

d. Disclosure Requirements

If a business relationship meets all three elements of a franchise, the Amended FTC Rule requires the creation of a franchise disclosure document (FDD), which must be provided to any potential franchisee no less than 14 days prior to the signing of a binding agreement, or prior to the franchisee making payment to the franchisor or an affiliate in connection with the proposed franchise sale.[37] Franchisors, including subfranchisors, are responsible for creating and providing the FDD to prospective franchisees, although the franchisor does not have to provide the FDD to the general public.[38] Franchisors can provide disclosure documents by any method they prefer,

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[32] *Id*. at 6–14 (Sale of franchises to be located outside of the United States and its Territories; minimum payment exemption; fractional franchise exemption; leased department exemption; oral agreements; petroleum marketers and resellers exemption; large franchise investment exemption; large franchisee exemption; insiders exemption).
[33] *Id*. at 15–16.
[34] *Id*. at 16.
[35] *Id*.
[36] Spandorf, *supra* note 8, at 37 n. 8.
[37] 16 C.F.R. § 436.2 (a) (2007).
[38] FTC Franchise Rule Compliance Guide, *supra* note 5, at 18.

including electronically, within some guidelines.[39] The disclosure document requires franchisors to include several items listed in the Amended FTC Rule, which generally tell parties how the franchise was created, the rights that are being granted to the franchisee, and payouts the franchisor will receive from requiring franchisees to purchase supplies and services from specific vendors.[40] Failure to comply with the disclosure requirement is deemed an unfair or deceptive act or practice, which violates Section 5 of the Federal Trade Commission Act.[41]

II. The Inadvertent Creation of a Franchise

a. Trademark Licensing

Trademark licensors may believe that the first element, the Trademark License Element, is easily met, and thus they may try to avoid the second, Control Element. This proves to be problematic. The Lanham Act places an affirmative duty on licensors to monitor the quality and uniformity of goods and services associated with their registered trademarks.[42] A licensor that fails to do so may be abandoning their trademark rights.[43] But in practice, it is difficult if not impossible to differentiate between trademark quality controls and the factors indicating significant control or assistance under the Amended FTC Rule.[44] Drafting licensing agreements around this issue may result in the abandonment of core business values or trademark rights.[45] Inadvertent franchises occur in trademark licensing precisely because franchise laws do not adequately distinguish between franchise and non-franchise licenses.[46]

b. Cases and Industry Examples

Innocent or unwary licensors are at risk of creating a franchise through their trademark licensing. Arguably one of the most innocent licensors, the national Girl Scouts organization inadvertently created a franchise.[47] The Girl Scouts of the United States of America (GSUSA) has created a network of local Girl Scout councils.[48] The relationship between GSUSA and a local council is governed by that local council's Girl Scout charter, which GSUSA issues to the local council for a nominal fee.[49] The Girl Scout charter includes, among other things, the right to use the GSUSA's names and protected marks, and requires the local council to operate in accordance with the policies established by GSUSA.[50] When GSUSA wanted to undergo a merger of local councils, and the Manitou Council refused, GSUSA took steps to remove more than half of Manitou Council's jurisdiction.[51] GSUSA was ultimately enjoined from altering its

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[39] 16 C.F.R. § 436.6 (f) (2007); FTC Franchise Rule Compliance Guide, *supra* note 5, at 18.
[40] 16 C.F.R. § 436.3–436.5 (2007).
[41] 16 C.F.R. § 436.2 (2007).
[42] Spandorf, *supra* note 8, at 40.
[43] *Id*.
[44] *Id*.
[45] *Id*.
[46] *Id*. at 5.
[47] *Girl Scouts of Manitou Council, Inc. v. Girl Scouts of the United States of America Inc.*, 549 F.3d 1079 (7th Cir. 2008).
[48] *Id*. at 1083.
[49] *Id*.
[50] *Id*.
[51] *Id*. at 1085.

relationship with the Manitou Council, after the Seventh Circuit held that the relationship fell under Wisconsin fair dealership law.

The Seventh Circuit reversed the district court's denial of a preliminary injunction under the likelihood that the local council would be successful on its Wisconsin state claims. At issue in the case, among other things, was the use of the Girl Scout trademarks, a key element in bringing the relationship under the purview of the Wisconsin statute.[52] This case raises concerns that similarly structured non-profits in which a national organization licenses its trademark to local organizations could be challenged under state laws.[53]

Franchises may also "sneak up" on licensors, who may be surprised to discover that over time they have created a franchise. In *To-Am Equip. Co. v. Mitsubishi Caterpillar Forklift Am.*, To-Am alleged the wrongful termination of a franchise without cause under the Illinois Franchise Disclosure Act.[54] Over the course of nine years, To-Am paid Mitsubishi $1,659 for parts and services manuals.[55] Unlike the Amended FTC Rule, the Illinois Franchise Disclosure Act has no time limit for meeting the total fee requirement of $500.[56] Here, the $500 franchise fee requirement could be met over the lifetime of the franchise, and was not limited to the first six months of the franchise existence. Because To-Am had paid more than $500 over the course of the entire business relationship, the Illinois District Court held that a franchise had been created under the Illinois Franchise Disclosure Act.[57] The Seventh Circuit upheld the decision and the jury's $1.525 million damage award.[58] In conclusion, the court stated:

> Like many manufacturers, MCFA simply did not appreciate how vigorously Illinois law protects "franchisees." This does not mean that terminations are impossible, but it does mean that they usually must be the subject of negotiation unless the manufacturer is able to show "good cause." MCFA has conceded that it cannot meet that standard, and it did not litigate the case under that theory. We have considered its remaining arguments and find nothing that requires reversal. 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.[59]

The court in *Charts v. Nationwide Insurance Co.* awarded another staggering judgment of $2.3 million dollars.[60] In that case, Nationwide Insurance Company terminated its agreement with Charts Insurance Associates, Inc, a small insurance agency selling Nationwide Insurance.[61] Charts Insurance Associates, Inc. then sued Nationwide

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[52] *Id*. at 1083–84, 1090–92.
[53] Constantine T. Fournaris and Robert S. Burstein, *Licensing Against the Wave of Franchising—Avoiding the Hidden or Inadvertent Franchise*, 29 LICENSING J. 1, 3 (2009).
[54] 152 F.3d 658, 661 (1998).
[55] *Id*. at 660; Fournaris, *supra* note 53, at 4.
[56] 152 F.3d at 662–64.
[57] *Id*. at 660.
[58] *Id*.
[59] *Id*. at 666.
[60] 397 F. Supp. 2d 357, 387 (2005).
[61] *Id*. at 361-62.

Insurance Company for violations of the Connecticut Franchise Act and the Connecticut Unfair Trade Practices Act.[62] The Connecticut District Court upheld the jury verdict regarding the Connecticut Franchise Act and Unfair Trade Practices Act claims, because the insurance agency was a franchise under the law, and Nationwide had not terminated their agreement for good cause, as required by the law.[63] However, on appeal, the Second Circuit reversed the Connecticut District court's ruling because Charts Insurance Associates failed to disclose the existence of the agreement with Nationwide during bankruptcy proceedings, and the claims brought by Charts Insurance Associates properly belonged to the bankruptcy estate, and therefore could not be brought by plaintiffs.[64] Nationwide Insurance only narrowly avoided the massive judgment awarded against them by the Connecticut District Court.

In *Gentis v. Safeguard Business Systems*, the California Court of Appeals upheld the lower court's ruling that Safeguard Business Systems, the parent company of manufacturer Gentis, was a franchise under the California Franchise Investment Law (CFIL).[65] There, Gentis solicited orders, installed systems, followed up on leads and referrals, and provided ongoing customer service to customers.[66] Although the Gentis agents did not have the authority to enter into a binding contract with customers, the appellate court still held that Gentis was "offering, selling or distributing" Safeguard Business Systems' goods and services, and was therefore a franchise under the CFIL.[67]

c. Harsh Consequences

Once a damaged party reports a potential or actual violation, clients face severe repercussions. Although there is no federal cause of action for creating an inadvertent franchise, the FTC may levy fines against a party who sells a "franchise" without complying with federal laws and regulation, without regard to the offending party's mental state.[68] FTC penalties may include permanent injunctions prohibiting the franchisor from continuing to operate its business, rescission of the contract, and restitution in federal court without the initiation of any administrative proceedings.[69] Based in consumer protection and U.S. securities laws, franchise laws impose strict liability and are construed liberally.[70] Franchise laws also impose joint and several personal liability among the franchisor executives and sales agents, in addition to criminal penalties.[71]

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[62] *Id*.
[63] *Id*. at 370.
[64] *Chartschlaa v. Nationwide Mut. Ins.Co.*, 538 F.3d 116, 122-24 (2d Cir. 2008).
[65] 60 Cal. App. 4th 1294, 1296-97 (1998).
[66] *Id*. at 1301.
[67] *Id*. at 1303.
[68] Lawrence G. Jameson, III, *Where Did That Franchise Come From?*, 28 S.C. LAW 32, 37 (2016).
[69] *Id*.
[70] Spandorf, *supra* note 8, at 41.
[71] Mark A. Kirsch and Rochelle B. Spandorf, *The Accidental Franchise*, AMERICAN BAR ASSOCIATION FORUM ON FRANCHISING, (October 10-12, 2001) 77, hosted by PLAVE KOCH PLC at http://www.plavekoch.com/documents/Accidental_Franchise_2001_ABA_Presentation_Paper_3741_.pdf (last visited Feb. 5, 2018).

Additionally, state unfair trade practices acts known as "little FTC acts" provide aggrieved parties with another opportunity to seek redress. Although the scope of the little FTC acts is like the federal FTC act, the remedies vary.[72] Some states provide for injunctive relief, some provide for recovery of monetary damages, and approximately half of the states provide for recovery of treble damages.[73] The requirements to recover treble damages also vary across the states.[74] Lastly, aggrieved parties may file claims in state court under the theories of fraud, misrepresentation, and violation of the respective state's unfair trade practices act.[75]

d. Malpractice

Law firms may also face harsh consequences for failing to properly advise clients regarding franchise and business opportunity laws. In *Beverly Hills Concepts v. Schatz & Schatz, Ribicoff & Kotkin, et. al.*, a Connecticut law firm narrowly avoided a $15 million verdict for the firm's failure to advise Beverly Hills Concepts regarding franchise law, registration and disclosure requirements.[76] Although the firm represented to the plaintiff that they were experts in the area of franchise law, attorneys at the firm failed to recognize a violation of the Connecticut Business Opportunities Act. The Connecticut Supreme Court affirmed that the law firm had committed malpractice, but set aside the damage recovery because the alleged losses were speculative.[77] In closing, the court noted that this decision was a "direct result of the plaintiff's choice of evidence" rather than the defendant law firm's absence of wrongdoing.[78] Attorneys and law firms alike should be careful not to overlook franchise issues, or they could face potential malpractice suits by their clients.

III. Best Practices for Avoiding an Inadvertent Franchise

a. A Rose By Any Other Name

Counsel should be wary of the names clients use to label their relationships, and counsel should be on notice that a simple disclaimer will not make the relationship immune from being categorized as a franchise. Some may attempt to avoid application of federal franchise law by including a clause in a trademark license agreement stating that the agreement does not create a franchise or franchisor-franchisee relationship. This will be insufficient to avoid being labeled as a franchise. The Amended FTC Rule specifically addressed this issue, and FTC guidance explicitly states that the "name given to the business arrangement is irrelevant in determining whether it is covered by the amended Rule."[79] The rule covers relationships that "are represented either orally or in writing as having the characteristics specified in the amended Rule's definition

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[72] Christine Lipsey and Dylan Tuggle, *Little FTC Acts and Statutory Treble Damages—Traps for the Unwary*, AMERICAN BAR ASSOCIATION (2017), https://apps.americanbar.org/litigation/committees/businesstorts/articles/1109_lipsey.html (last visited Feb. 5, 2018).
[73] *Id*.
[74] *Id*.
[75] Kirsh, *supra* note 71, at 22–26.
[76] CV89-0369864-S, 1997 Conn. Super. LEXIS 178, at *68–69 (Super. Ct. Jan. 27, 1997).
[77] *Beverly Hills Concepts v. Schatz & Schatz*, 717 A.2d 724, 739–40 (Conn. 1998).
[78] *Id*. at 749.
[79] FTC Franchise Rule Compliance Guide, *supra* note 5, at 1.

of 'franchise,' regardless of whether the representations are, in fact, true or can be fulfilled."[80] If a contract is structured specifically to avoid a franchise definitional element or to take advantage of an exemption or exclusion, the contract recitals or acknowledgement should point out these features. But a conclusory statement that the agreement does not create a franchise will fall short of the intended outcome. Although statements pointing out the inapplicability of franchise elements won't completely insure that the relationship will not be challenged, they can help a licensor respond to a challenge. In short, a franchise by any other name will still be a franchise regulated by the FTC.[81] Be sure to look at the facts, not just what the client tells you.

b. Avoiding the Franchise Fee

In each trademark licensing agreement, practitioners should carefully examine the amount and dates for payments of all types from the licensee to the licensor. Simply, follow the entire cash from licensee to licensor. The federal franchise fee element can be avoided if the fee that a "franchisee" is required to pay within the first six months of operation does not exceed $500. The Amended FTC Rule specifically provides such an exemption. Commencing operations is defined as "when [the franchise] first makes goods or services available for sale."[82] An agreement entered into during the first six months of operation that requires payments later than six months after commencing operation, does not count toward the $500 calculation.[83] Moreover, only required payments will count towards the calculation.[84] However, parties should be careful in labeling payments as optional when they are effectively required for the successful operation of the venture.[85] By carefully structing payment amounts and timelines, practitioners can eliminate application of the payment element in the three prong "franchise" definition. Furthermore, as noted in the *To-Am* case above, state franchise laws may not have a time limit.

c. Keep Exemptions and Exclusions in Mind

The specific facts and circumstances of a trademark license may allow the application of a federal or state exemption or exclusion. Keep these in mind when drafting license agreements, and if the parties intend to take advantage of an exemption or exclusion, state that clearly in the agreement. Be intentional and forward thinking in your approach to avoiding application of a franchise law or the Amended FTC Rule.

d. If the Licensor Provides Inventory or Supplies

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[80] *Id*.
[81] *See United States v. Lasseter*, No. 3:03-1177, 2005 U.S. Dist. LEXIS 23426 (M.D. Tenn. July 1, 2005) (granting the government's motion for summary judgment on liability where defendant argued the business was not a franchise and therefore was not required to comply with disclosure requirements, and ordering franchisor to pay civil penalties of $56,000); *F.T.C. v. Tiny Doubles Int'l*, No. 94-15752, 1996 U.S. App. LEXIS 1663 (9th Cir. Jan. 18, 1996) (granting FTC's motion for summary judgment, and entering a permanent injunction and a monetary judgment for consumer redress where defendant failed to comply with FTC franchise disclosure requirements, told prospective buyers that the business was not a franchise, and where defendant's sole defense was that the business was not a franchise operation).
[82] FTC Franchise Rule Compliance Guide, *supra* note 5, at 7.
[83] *Id*.
[84] Spandorf, *supra* note 8, at 40
[85] *Id*.

If a licensor wants to provide a licensee with inventory or supplies for resale or lease, the agreement between the parties should state that the items will only be purchased at the bona fide wholesale prices, and only in quantities reasonable to begin or continue inventory or supply. By so limiting the inventory or supplies provided to the licensee, the licensor can again prevent the application of the payment element in Amended FTC Rule.

e. Discovering a Violation

On discovering a potential violation of franchise laws, trademark licensors should take prompt remedial action to address the violation or violations. This may include restructuring or renegotiating agreements, analyzing defenses, self-reporting to a government regulator, or offering rescission to affected licensees.[86] In considering which action to take, a licensor should consider whether it would like to create a franchise in the future, the jurisdictions in which the licensor operates, and its relationship with the licensees.[87]

IV. Hypothetical Example

A local Italian Restaurant, Mama Marinara, has gained national attention for its delicious marinara sauce. Mama Marinara decides to sell bottling rights to Bottlers and allow Bottlers to use the Mama Marinara name in their business. Mama Marinara licenses its top secret marinara sauce recipe to Bottlers, who will then make and sell the sauce according to Mama Marinara's strict standards. Bottlers must buy all the sauce ingredients from Mama Marinara. Mama Marinara also implements advertisements to assist in the sale of the marinara sauce produced by Bottlers. Is this a franchise?

V. Conclusion

To fully protect clients, attorneys should carefully evaluate whether the trademark licensing arrangement at issue will create a franchise. While franchise laws can be helpful for the intentional practitioner, they can be harmful when inadvertently implicated. Through cautious analysis and best practices, attorneys can identify and avoid the inadvertent creation of a franchise when licensing trademarks.

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[86] Carlos L. White, *Having the "Are You Operating an (Illegal) Franchise System Without Knowing It?" Conversation*, K&L GATES (April 18, 2016), http://www.klgates.com/having-the-are-you-operating-an-illegal-franchise-system-without-knowing-it-conversation-04-18-2016/.
[87] *Id.*