A Crash Course on Interpretation of the "Marketing Plan or System" Element of State Franchise Statutes

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I. Introduction

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Many commentators have written and spoken about accidental franchises and the definitional element of a "franchise" known as the "marketing plan or system," how it has been interpreted, and what happens when an unsuspecting "franchisor" gets it wrong.[1] Yet, the ever-changing landscape of evolving business arrangements requires continued attentiveness to, and understanding of, the law as it develops and may apply to novel business practices. Oversight of a franchise system by a franchisor requires compliance with both the pre-sale disclosure requirements under the Federal Trade Commission's (FTC) Franchise

1. *See, e.g.*, Megan B. Center, *Accidental Franchises: It Takes a Community (of Interest)*, 39 Franchise L.J. 546 (2020); Paul R. Fransway, *Traversing the Minefield: Recent Developments Relating to Accidental Franchises*, 37 Franchise L.J. 217 (2013); Charles S. Modell, *The Accidental Franchise, When a Business Relationship Becomes a Trap*, 13 Bus. L. Today 45 (Jan./Feb. 2004); Daniel J. Oates, Shannon L. McCarthy & Douglas C. Berry, *Substantial Association with a Trademark: A Trap for the Unwary*, 32 Franchise L.J. 130 (2013); James R. Sims III & Mary Beth Trice, *The Inadvertent Franchise and How to Safeguard Against It*, 18 Franchise L.J. 54 (1998); Rochelle Spandorf, *Structuring Licenses to Avoid the Inadvertent Franchise*, 2:4 Landslide 35 (Mar./Apr. 2010).

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Rule (the FTC Rule) and a patchwork of state franchise statutes (that regulate both pre-sale conduct and post-signing relationship). However, certain businesses that would not believe they are operating a franchise system may subject themselves to applicable franchise statutes based on their conduct and underlying agreements and business relationships (even if unintended).[2] The FTC Rule does not provide a private right of action to aggrieved third parties; however, many state franchise statutes provide a right of action for its citizens against what many deem an "accidental" or "inadvertent" franchisor.[3] Unfortunately, for the "accidental" or "inadvertent" franchisor, and its executives and salespeople in certain states, those statutory claims may result in an award of damages, rescission, injunctive relief, and attorneys' fees. Thus, franchise lawyers must understand the ins and outs of the definitional elements of a franchise under both federal and state law. This article analyzes the case law that interprets the bothersome definitional element known as the "marketing plan or system." Section II covers the FTC's statutory definition of a franchise under the FTC Rule. Section III discusses how various states define the effect of marketing plan usage by rule, statute, or common law. Finally, Section IV provides final thoughts and guidance regarding the proscription of marketing plans in various businesses.

II. The FTC Rule Definition of a Franchise

The FTC Rule governs, and sets a baseline for the regulation of, the offer and sale of franchises in the United States.[4] The FTC Rule defines a "franchise" as

> any 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:
> (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;
> (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; and
> (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.[5]

2. *See, e.g.*, 16 C.F.R. § 436.1 *et seq.*
3. *See* Dale E. Cantone, Kim A. Lambert & Karen C. Marchiano, *So It Really Is a Franchise: Bringing Non-Compliant Franchisors into Compliance*, Am. Bar Ass'n 37th Ann. Forum on Franchising, W–18 (2014). In addition, violation of these laws may be grounds to assert a state consumer or deceptive trade practices act claim. *Id.*
4. *See* 16 C.F.R. § 436.1 *et seq.*
5. 16 C.F.R. § 436.1(h).

A commercial relationship or arrangement is deemed a "franchise" under the FTC Rule when it meets all three of the elements described above.[6]

Twenty-six states also regulate the offer and sale of franchises. Of those states, several utilize the grant of a "marketing plan or system" prescribed in substantial part by the franchisor, instead of the second element of "assistance/control" in the FTC Rule, in their definition of a franchise.[7]

Judicial and regulatory interpretation of these statutes has yielded vastly different results. Thus, a company's failure to evaluate how a particular state defines a franchise, and how courts interpret that particular definition, can have substantial consequences for its business model because state authorities could impose penalties and fines not only for the franchisor-company but the franchisor-officers as well.

III. State-by-State Survey of the Definitional Element of a "Marketing Plan or System"

A. *California*

In California, the California Corporations Code, covering both the California Franchise Relations Act (CFRA) and the California Franchise Investment Law (CFIL), defines a "franchise" as a contract or agreement whereby a person operates a business "under a marketing plan or system prescribed in substantial part by a franchisor," in which the plan is substantially associated with the franchisor's trademark name or other commercial symbol that designates the franchisor, and the franchisee must pay a franchise fee.[8]

California courts have set forth the broadest interpretation of a "franchise." In *Boats & Motor Mart v. Sea Ray Boats, Inc.*, Boats & Motor Mart (Boats) sold powerboats manufactured by Sea Ray pursuant to a license agreement.[9] Throughout their course of dealing, Sea Ray agreed to provide press kits, marketing advice, and training for Boats' sales representatives and, in turn, Boats agreed to aggressively sell, display, and advertise Sea Ray products.[10] When Sea Ray discontinued sales of its products to Boats, Boats filed suit pursuant to the CFRA, which, if applicable, would prohibit Sea Ray's termination absent good cause.[11] Thus, the CFRA's applicability to the parties relationship was dispositive. In defining a "franchise," the CFRA

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6. *Id.*

7. *See, e.g.*, Haw. Rev. Stat. § 482E-2; Minn. Stat. § 80C.01; Miss. Code § 75-24-51(6); Mo. Rev. Stat. § 407.400(1); Neb. Rev. Stat. § 87-402(1); N.J. Stat. § 56:10-3(a); S.D. Codified Laws § 37-5A-3; Wis. Stat. § 135.02.

8. *See* Cal. Corp. Code § 31005(a); *see also id.* § 31005(b) (noting the definition of "franchise" also applies to certain contracts in the oil and gas industry); *id.* § 31005(c) (noting the definition of "franchise" does not apply to certain retail co-ops that operate on a non-profit basis).

9. *See* Boat & Motor Mart v. Sea Ray Boats, Inc., 825 F.2d 1285, 1285–86 (9th Cir. 1987) (applying California law).

10. *Id.* at 1287.

11. *Id*. at 1288. The parties' agreement contained a provision permitting termination on thirty days' written notice and waived liability for losses arising out of the agreement. *Id.*

referenced guidelines issued by the California Department of Corporations (now known as the California Department of Financial Protection and Innovation (CDFPI)).[12] The court found that the guidelines indicated that a franchisee is "one of several outlets selling a manufacturer's product," and, by causing the "outlets" to operate with uniformity with respect to the quality and price and under the appearance of centralized management, the manufacturer assumed responsibility for them.[13] Based on the extensive advertising and promotional materials issued by Sea Ray, Sea Ray's territorial advertising restrictions, and Sea Ray's detailed instructions on employee and other business practices, the court held that Boats was in fact a franchisee because it followed a system prescribed in a substantial part by Sea Ray.[14]

In *People v. Kline*, the California Court of Appeals held that a marketing plan existed, even if not fully detailed, when a hotdog kiosk seller (Kline) promised to provide a prospect (and purported franchisee) with a distinctive retail location and business name.[15] Kline was convicted of one count of unlawful sale of a franchise under the CFIL for offering to sell, and actually selling, the right to operate distinctive hotdog kiosks operating under the name "Aunt Hilda's Pennsylvania Dutch Steamed Franks."[16] Kline told the prospect that he was offering a franchise for $25,000.00 and that the entire operation would be "turn key."[17] Kline provided documents outlining projected sales and expenses and told the prospect that an expert would handle the menu.[18] Kline led the prospect to believe that the day-to-day operations would be handled by Kline's company.[19] At trial, Kline argued that the business opportunities he sold did not constitute a "franchise" by arguing that California had a more limited definition of a franchise than other states.[20] Specifically, Kline based his argument on the guidelines that CDFPI issued in 1974.[21] Noting that the 1974 guidelines were not determinative and that the final determination on interpretation of a statute rested with the courts, the court explicitly rejected a narrow interpretation of what would constitute a marketing plan, reasoning that the legislature's intent was to protect franchisees.[22] The court found that, by agreeing to provide sales and marketing assistance, menu planning, and the use of "identifiable and distinctive" kiosks, Kline had "at least implied" a statutory marketing plan.[23]

12. *Id.*
13. *Id.* at 1289.
14. *Id.* (citing Cal. Dep't of Corps., Release 3-F (1974)).
15. *See* People v. Kline, 110 Cal. App. 3d 587, 594 (Ct. App. 1980).
16. *Id.* at 594, 598.
17. *Id.* at 591.
18. *Id.*
19. *Id.*
20. *Id.* at 593.
21. *Id.*
22. *Id.* at 594–95.
23. *Id.* at 594.

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After these decisions, the CDFPI issued further guidelines in 1994 to clarify when an agreement or relationship constitutes a franchise.[24] The guidelines, based on prior interpretive opinions, thoroughly outlined the requirements for a franchise to be found under California law.[25] One such requirement is that the purported franchisee *must* operate under a marketing plan or system prescribed in substantial part by the franchisor.[26] *The 1994 Guidelines* explain that if a franchisee is free to sell products according to the franchisee's own systems, methods, or ideas, then no marketing plan exists.[27] On the contrary, if a franchisor claims that it has a successful marketing plan to provide to a prospective franchisee, courts may presume the existence of a marketing plan.[28] A franchisor's control over the payment, credit, and warranty practices of the franchisee may also suggest the existence of a marketing plan.[29] Likewise, when a franchisor prohibits certain methods of distribution or when a franchisor provides the franchisee with "sales aids or props," even if only *recommending* use of the same, a marketing plan may exist by implication.[30] However, the mere imposition of a business procedure or technique that is to some extent restrictive will not constitute a marketing plan if the same is "customarily observed in business relationships in the particular trade or industry."[31] For example, a contractual obligation for one party to use "best efforts" to make sales does not constitute a marketing plan or system prescribed in substantial part by the franchisor.

Following the issuance of *The 1994 Guidelines*, in *US Mac Corp. v. Amoco Oil Co.*, the California Court of Appeal held that a franchise relationship existed because the relationship between the parties satisfied the marketing plan element.[32] Specifically, Amoco granted US Mac the right to distribute its products in China and, in connection with the distributorship, the right to use Amoco trademarks and marketing materials.[33] However, Amoco required, under the distribution agreement, that any materials bearing its trademarks indicate that US Mac was an independent distributor.[34] When Amoco required US Mac to purchase $1.2 million in product, which was not part of the original distribution agreement, US Mac alleged that a franchise agreement existed and that Amoco had materially modified it.[35] The court looked to the terms of the distribution agreement and held that a marketing

24. *See* Cal. Dep't of Bus. Oversight, Commissioner's Release 3-F: When Does an Agreement Constitute a "Franchise" (1994), https://dfpi.ca.gov/commissioners-release-3-f [hereinafter *The 1994 Guidelines*].

25. *Id.*

26. *Id.*

27. *Id.* (citing Comm'r Opinion No. 71/25F).

28. *Id.* (citing Comm'r Opinion Nos. 75/2F, 79/2F, and 4736F).

29. *Id.*

30. *Id.* (citing Comm'r Opinion No. 73/40F).

31. *Id.* (citing Comm'r Opinion No. 71/42F).

32. *See generally* US Mac Corp. v. Amoco Oil Co., No. B137658, Bus. Franchise Guide ¶11,963 (Cal. Ct. App. Aug. 16, 2000).

33. *Id.* at 3.

34. *Id.*

35. *Id.* at 4.

plan existed because Amoco (1) restricted US Mac's ability to sell certain products; (2) provided US Mac with specialized training; and (3) provided US Mac with detailed advice on sales.[36]

Even to the present day, California courts have relied on *The 1994 Guidelines* in determining whether a franchise relationship exists under the CFIL. In *Sunflora, Inc. v. Natural Solutions, LLC*, the U.S. District Court for the Central District of California relied on *The 1994 Guidelines* in holding that several restrictions in an exclusive territory agreement indicated the existence of a marketing plan and therefore a franchise relationship.[37] The court noted that "[w]hile any one of the examples of restrictions may not amount to 'a marketing plan or system prescribed in substantial part by a franchisor,' several such restrictions taken together may be sufficient to amount to such a plan or system."[38] Sunflora alleged that Natural Stone, the purported franchisor, misrepresented the nature of the documents governing the parties' relationship—which Sunflora contended actually constituted a franchise agreement.[39] Sunflora further alleged that a franchise agreement did exist, because there were indirect franchise fees built into the goods they were required to purchase and, thereby, a marketing system that it had to abide by according to the factors outlined in *The 1994 Guidelines*.[40] The court denied Natural Stones' motion to dismiss because Natural Stone: (1) prescribed or limited resale prices; (2) restricted the use of advertising or mail order business; (3) gave detailed directions and advice concerning operating techniques; (4) assigned an exclusive territory; (5) limited the sale of competitive products; (6) provided for uniformity or distinctiveness of appearance; and (7) prohibited engaging in other activities.[41] Each of these indicators, together, constituted a marketing plan under applicable law.[42]

B. *Connecticut*

Similar to California, in Connecticut under the Connecticut Franchise Act (CFA), a "franchise" is defined by statute as a contract or agreement whereby a franchisee is granted the right to operate a business "under a marketing plan or system prescribed in substantial part by a franchisor," which plan is substantially associated with the franchisor's trademark name or other commercial symbol that designates the franchisor, and includes "any agreement between a manufacturer, refiner, or producer and a distributor."[43]

In deciding whether a marketing plan exists, the courts consider the parties' written agreement; however, because language can be deceptive, courts

36. *Id.* at 8.
37. *See* Sunflora, Inc. v. Nat. Sols., LLC, No. CV2001141CJCMRWX, 2021 WL 8316392 (C.D. Cal. Dec. 16, 2021).
38. *Id.* (quoting *The 1994 Guidelines*, *supra* note 24).
39. *Id.* at *1.
40. *Id.*
41. *Id.* at *3.
42. *Id.* at *5.
43. *See* Conn. Gen. Stat. 42-133e(b).

will look beyond the written agreement and consider the "reality" of the relationship between the parties by observing their conduct.[44] If a court finds a contract ambiguous such that it is allowed to also consider the parties' intent, courts examine the control that a potential franchisor has over a purported franchisee.[45] Although, as noted by the Connecticut Supreme Court, there is no "precise formula as to how many or which factors create the level of control indicative of a franchise,"[46] and several courts have relied on the list of factors set out in *Consumers Petroleum of Connecticut, Inc. v. Duhan* to determine whether a marketing plan existed in a gasoline distributorship.[47] There, the court analyzed whether the franchisor had control over (i) hours and days of operation; (ii) advertising; (iii) lighting; (iv) employee uniforms; (v) prices; (vi) trading stamps; (vii) hiring; (viii) sales quotas; and (ix) management training.[48] Analyzing the above factors, the court in *Duhan* found insufficient evidence of a marketing plan and no franchise relationship where the lessor (i) set the monthly rent based on the number of gallons of gasoline sold with a minimum rent of $400 per month; (ii) required that the station not to be closed for a period in excess of forty-eight hours; (iii) set the hours of operation; (iv) required that no advertising signs be placed on the premises without the permission of the lessor (purported franchisor); (v) required that the lessee provide the necessary number of employees to run the business; and (vi) would lend certain equipment to the lessee to be used for storing and dispensing products sold by the lessor only.[49]

In *Hartford Electric Supply Co. v. Allen-Bradley Co.*, the Connecticut Supreme Court interpreted whether a distribution agreement constituted a franchise agreement when a manufacturer of high-tech industrial automation products terminated a distributor who, in turn, sought protection under the CFA.[50] The distributor sought a temporary injunction restraining the manufacturer from terminating the distribution agreement and alleged, *inter alia*, that the manufacturer qualified as a "franchisor" and violated the CFA for terminating the agreement without good cause.[51] In determining whether the CFA applied, the court analyzed "whether a marketing plan or system [was] substantially prescribed."[52] Finding the CFA applied to the parties' relationship, the court interpreted the definition of a marketing plan broadly in favor of the distributor, based on the legislative intent of the CFA

44. *See* Hartford Elec. Supply Co. v. Allen-Bradley Co., 250 Conn. 334, 348 (1999) (quoting Petereit v. S.B. Thomas, Inc., 853 F. Supp. 55, 60 (D. Conn. 1993)).

45. *See, e.g.*, *Hartford Elec. Supply Co.*, 250 Conn. at 348 (explaining the need to examine "actions" that constitute an agreement or arrangement between the parties).

46. *Id.*

47. Consumers Petroleum of Conn., Inc. v. Duhan, 38 Conn. Supp. 495 (Conn. Super Ct. 1982).

48. *Id.* at 498–99.

49. *See id.* at 498.

50. *See* Hartford Elec. Supply Co. v. Allen-Bradley Co., 250 Conn. 334, 335 (1999).

51. *Id.* at 343.

52. *Id.* at 348.

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to prevent a franchisor from unfairly exercising leverage on a franchisee.[53] The court relied on the factors in *Consumers Petroleum* and stated that pricing is "one of the most significant" factors to consider, and a statutory marketing plan is likely found when a franchisor has significant control over a franchisee's pricing.[54] Additionally, the court stated that when a franchisor provides marketing and sales support, requires a franchisee to submit regular audited financial statements, requires franchisee to maintain and utilize a training center according to the franchisor's specifications, or exercises significant control over a franchisee's inventory or hiring decisions (by threat of termination or otherwise), then it is likely that a statutory marketing plan exists.[55]

As demonstrated below, when determining whether a statutory marketing plan exists, the courts look at the level of control a franchisor exerts over a franchisee's business. The Connecticut Petroleum Franchise Act (CPFA) substantively mirrors the statutory definition of a franchise and applies to the oil and gas industry.[56] When interpreting the CFA, some courts have sought guidance from opinions interpreting the CPFA.[57] In *Ackley v. Gulf Oil*, the court stated that when a gas station operator maintains complete control over advertisement, prices, operational hours, employee selection, and financial records, the gas station operator does not operate the business according to a statutory marketing plan.[58]

In *Chem-Tek, Inc. v. General Motors Corp.*, interpreting the CFA, the U.S. District Court for the District of Connecticut found that when a party to an agreement (i) controls the hiring and firing of franchisee employees; (ii) provides financial assistance for salaries and advertising material; (iii) organizes marketing conferences; (iv) sets the prices for products; and (v) prohibits the other party from offering products other than those specified by the setting party, then the other party is operating a business according to a marketing plan.[59]

Likewise, when a purported franchisor exerts "overwhelming" control of a purported franchisee's business, that party operates its business according to a statutory marketing plan.[60] In *Carlos v. Phillips Business Systems, Inc.*, the U.S. District Court for the Eastern District of New York, analyzing Connecticut law, found that, within the meaning of the CFA, "overwhelming control" exists when a party must (1) prominently display the other party's

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53. *Id.* at 349, 357.

54. *See id.* at 351–52.

55. *See id.*

56. Conn. Gen. Stat. § 42-133j-n.

57. *See* Chem-Tek, Inc. v. Gen. Motors Corp., 816 F. Supp. 123, 129 (D. Conn. 1993) (applying Connecticut law) (citing Consumers Petroleum of Conn., Inc. v. Duhan, 452 A.2d 123 (Conn. Super. Ct. 1982)).

58. *See* Ackley v. Gulf Oil Corp., 726 F. Supp. 353, 355 (D. Conn. 1989) (applying Connecticut law).

59. *See Chem-Tek*, 816 F. Supp. at 129.

60. *See* Carlos v. Philips Bus. Sys., Inc., 556 F. Supp. 769, 776 (E.D.N.Y. 1983) (applying Connecticut law).

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logo on entranceways and letterhead; (2) answer the phone in a manner prescribed by the other party; (3) conform to warranty policies; (4) hire salespeople at the request of the other party; (5) provide periodic sales reports to the other party; (6) maintain specified levels of inventory; (7) conform to advertising and promotional policies set by the other party; (8) purchase inventory at unfavorable prices; and (9) submit to franchisor decisions in negotiations with third-parties.[61]

Comparatively, when a distributor's business operations are independent of a supplier's control, courts have held that no marketing plan or system exists under the CFA.[62] For example, a lessor merely prescribing lessee's business hours and days of operation and requiring its approval for advertising signs are likely insufficient to find that a lessee is operating under a statutory marketing plan.[63] Some courts have even found that a marketing plan did not exist where a manufacturer set sales quotas, recommended retail prices with set price caps and sale strategies, and set annual meetings.[64] Likewise, in *Aurigemma v. Arco Petroleum Products Co.*, the U.S. District Court for the District of Connecticut found no franchise relationship existed under the CFA, where a lessor placed certain restrictions on a lessee.[65] The court reasoned that the lessor's requirements that the lessee maintain sufficient inventory, fully illuminate the premises, maintain employee uniforms, and be subject to safety inspections and financial audits, alone, did not eliminate the lessee's independence or create a marketing plan.[66] The court reached its conclusion by analyzing whether the lessor, through its restrictions, "usurp[ed] the operator's ability to exercise independent judgment on marketing decisions," concluding that it did not.[67] Additionally, some courts have found that when a lessor sells products to a lessee, and allows the lessee to use the lessors trademark, those facts alone do not constitute a statutory marketing plan.[68]

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61. *Id* at 776–77; *see also* Kollar v. Allstate Ins. Co., 2018 WL 4688301, at *8 (D. Conn. Sept. 28, 2018) (finding that an independent insurance agent stated a valid claim for violations of the Connecticut Franchise Act where the insurance company, *inter alia*, required the agent to exclusively offer and sell Allstate products).

62. Ross v. Shell Oil Co., 672 F. Supp. 63, 66 (D. Conn. 1987) (holding that minimum control requirements for a marketing plan were not met where the purported franchise agreement did not set minimum purchase amounts, prices, or sales quotas).

63. *See* Consumers Petroleum of Conn., Inc. v. Duhan, 38 Conn. Supp. 495, 498 (Super. Ct. 1982) ("[T]hese factors alone are insufficient to sustain a finding that there was a marketing plan or system present in the case before us.").

64. *See* Dittman & Greer, Inc. v. Chromalox, Inc., 2009 WL 3254481 (D. Conn. Oct. 6, 2009) (applying Connecticut law).

65. *See generally* Aurigemma v. Arco Petroleum Prods. Co., 698 F. Supp. 1035 (D. Conn. 1988).

66. *See id. at* 1040.

67. *See id.*

68. *See* R. R. Murty Narumanchi v. Shell Oil Co., Bus. Franchise Guide ¶ 8720 (D. Conn. Dec. 10, 1986).

C. *Illinois*

The Illinois Franchise Disclosure Act (IFDA) defines a "franchise" by requiring the grant of a marketing plan or system prescribed or suggested in substantial part by a franchisor, association with a franchisor's trademark, name, or logo, and a franchise fee of five-hundred dollars ($500) or more.[69] Additionally, the IFDA itself outlines several characteristics of a marketing plan, including specification of price or discount plans, use of particular sales or display equipment, specific sales techniques, and specific advertising or promotional materials.[70]

Under the IFDA, a marketing plan or system does not need to be detailed or comprehensive; the element is satisfied when the franchisee has the right to sell under a marketing plan, even if the franchisee is not obligated to do so.[71] A party's provision of, or a mere agreement to provide, another party with training, promotional materials, and direct sales assistance is sufficient to find a marketing plan under the IFDA.[72] However, a sales agreement where the manufacturer does not assist in the "affirmative act" of offering and selling products does not satisfy the requirements of a marketing plan or system and the definition of a "franchise" under the IFDA.[73]

D. *Indiana*

Under the Indiana Franchise Act (IFA), a franchise exists when the operator of a business has the right to sell goods or services under a marketing plan or system prescribed in substantial part by a franchisor; there is substantial association with the franchisor's trademark, name, or logo; and there is a franchise fee.[74]

69. *See* 815 Ill. Comp. Stat. 705/3(1).

70. *See id.* at 705/3(18) ("Marketing plan or system" 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; provided that an agreement is not a marketing plan or system solely because a manufacturer or distributor of goods reserves the right to occasionally require sale at a special reduced price which is advertised on the container or packaging material in which the product is regularly sold, if the reduced price is absorbed by the manufacturer or distributor.").

71. *See* To-Am Equip. Co. v. Mitsubishi Caterpillar Forklift Am., Inc., 953 F. Supp. 987, 994 (N.D. Ill. 1997) (finding that "advice about how to run the business need not be comprehensive in order to amount to a 'marketing plan'").

72. *See* Blankenship v. Dialist Int'l Corp., 568 N.E. 2d 503, 506 (Ill. Ct. App. 1991); *see also* Salkeld v. V.R. Bus. Brokers., 548 N.E.2d 1151, 1156 (Ill. Ct. App. 1989) (holding that when a producer offers support to a licensee in marketing, training, advertisement, and promotion, then the producer has "amply" satisfied the statutory requirements of a marketing plan).

73. *See* Account Servs. Corp. v. DAKCS Software Servs., Inc., 208 Ill. App. 3d 392, 398 (Ill. App. Ct. 1990) (finding no franchise where an alleged "plan" that did not "assist the plaintiffs in the affirmative act of selling or their offering of [] services").

74. *See* Ind. Code § 23-2-2.5-1; *see also* Ind. Code § 9-32-2-13 (noting definition of franchise changes and does not include a marketing element when dealing with a vehicle manufacturer and distributor); Ervin Equip. Inc. v. Wabash Nat'l Corp., 187 F. Supp. 3d 968, 977 (N.D. Ind. 2016) (noting dealers can claim violation of Indiana franchise law using both the franchise

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Indiana courts have outlined several factors to consider in determining whether a marketing plan or system exists under the IFA.[75] Indiana courts have recognized the existence of a marketing plan where a producer exercises significant control over a distributor's business operations, particularly, in the areas of (1) geographic control of sales; (2) sales quotas; and (3) control of employee training and sales.[76] The primary factor is whether a purported franchisor places substantial restrictions on a purported franchisee's business and marketing decisions.[77] In *McLane v. Pizza King Franchises*, the Indiana Superior Court found that the mere use of "franchise" in a party's corporate name does not necessarily create a franchise relationship and that the existence of only one or two restrictions that a party does not deem "substantial" will not, by itself, create a statutory marketing plan under the IFA.[78] Specifically, a wholesaler's restriction of the location of a retailer and manner of retail delivery does not constitute a substantial restriction, and, because the minimum control requirements of a marketing plan were not met, no franchise relationship existed, and the IFA did not govern the relationship.[79] Similarly, a party's provision of free promotional materials and recommended prices to its counterparty will not constitute a marketing plan or system under the IFA.[80]

E. *Maryland*

The Maryland Franchise Registration and Disclosure Law (MFRDL) is nearly identical to the CFA.[81] In *Koehler Enterprises, Inc. v. Shell Oil Co.*, the U.S. District Court for the District of Maryland even cited to several cases interpreting the CFA to support its conclusion that when a distributor acts independently of a supplier's control, a marketing plan does not exist.[82] There, a distributor alleged that the supplier induced the operator

definition specific to manufacturer-dealer relationship, and the general definition of franchise that has the marketing plan element).

75. *See*, *e.g.*, McLane v. Pizza King Franchises, No. S 356-86, 1987 WL 92061 (Ind. Super. Ct. Sept. 4, 1987).

76. *See* Master Abrasives Corp. v. Williams, 469 N.E. 2d 1196, 1200 (Ind. Ct. App. 1984); *see also* Hoosier Penn Oil Co. v. Ashland Oil Co., 934 F. 2d 882 (7th Cir. 1991) (holding that when a manufacturer does not exercise significant control over distribution areas, employee hiring and training, sales quotas, and communication with distributor clients, then the manufacturer has not prescribed a marketing plan or system).

77. *See McLane*, 1987 WL 92061, at *9.

78. *Id.* at 10.

79. *Id*.

80. *See* Richard I. Spiece Sales Co. v. Levi Strauss N. Am., 19 N.E.3d 345, 357–58 (Ind. App. 2014).

81. *See* Md. Code, Bus. Reg. § 14-201(e) ("'Franchise' means an expressed or implied, oral or written agreement in which: (i) a purchaser 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 the franchisor; (ii) the operation of the business under the marketing plan or system is associated substantially with the trademark, service mark, trade name, logotype, advertising, or other commercial symbol that designates the franchisor or its affiliate; and (iii) the purchaser must pay, directly or indirectly, a franchise fee.").

82. *See* Koehler Enters., Inc., et.al. v. Shell Oil Co., Bus. Franchise Guide ¶10,252 (D. Md. Feb. 12, 1993); *see also id.* at *10 (citing numerous Connecticut decisions on the CFA).

of a gasoline service station to execute a second agreement on the basis of a series of false representations as to the supplier's then-present intention regarding the type of service station that would be constructed.[83] At one point, the distributor even declined to execute the "franchise" agreement on the basis of perceived discrepancies between the parties' oral negotiations and the written agreement as proposed.[84] Ultimately, the distributor claimed that the supplier convinced the distributor to execute the agreement based on the franchisor's oral interpretation of the written agreement at closing.[85] The court denied summary judgment as to both intentional and negligent misrepresentation claims asserted under the MFRDL, holding that the minimum control requirements of a marketing plan were not present and, thus, no franchise relationship existed.[86]

F. *Michigan*

Under Michigan's Franchise Investment Law (MFIL), the "franchise" definition utilizes several characteristics that guide Michigan courts in determining whether a marketing plan exists, including requirements that (1) the franchisee purchase most of its goods from the franchisor or approved vendors; (2) the franchisee follow an operating plan, standard procedure, training manual, or substantial equivalent; (3) the franchisor assists with training franchisee employees; (4) the franchisor assist with finding franchisee locations; and (5) the franchisor assists the franchisee with marketing the franchisor's products.[87] Additionally, the statute also considers limitations placed on the franchisee regarding the type, quality, or quantity of goods and services that the franchisee may provide to its customers, or whom the franchisee can sell to, as factors indicating that a marketing plan is in place.[88]

G. *New York*

New York's statutory definition of a franchise differs from other states in that a franchise relationship exists where just one of the two prongs is satisfied: substantial association with a franchisor's trademark, name, or logo, and a franchise fee paid, *or* a marketing plan/system prescribed in substantial part by the franchisor and a franchisee fee paid.[89] New York courts have created a narrower definition of marketing plan, where licensees or distributors must prove that the licensor or manufacturer exercised significant control over daily business operations in order to claim the existence of a marketing plan.[90] New York's narrower approach may be due to their more lenient

83. *Id.*
84. *Id.*
85. *Id.*
86. *Id.*
87. *See* Mich. Comp. Laws. § 445.1502(3) (1984); Mich. Admin. Code r. 445.101.
88. *See* Mich. Admin. Code r. 445.101.
89. *See* N.Y. Gen. Bus. Law § 681(3).
90. *See*, *e.g.*, Safe Step Walk in Tub Co. v. CKH Indus., Inc., 242 F. Supp. 3d 245 (S.D.N.Y. 2017); *see also* Aristacar Corp. v. Attorney General, 541 N.Y.S.2d 165, 167 (Sup. Ct. 1989) (holding

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inquiry of whether a franchise exists. The court in *Safe Step Walk in Tub Co. v. CKH Industries, Inc.*, reasoned that a "marketing plan," as defined by New York law, is essentially the same as the control requirement promulgated by the FTC's definition of a franchise.[91] In *Safe Step*, CKH entered into a distribution agreement to sell and install Safe Step tubs in the greater New York City area.[92] The agreement explicitly stated that CKH was an independent contractor, not a franchisee.[93] However, Safe Step required CKH to meet either a minimum sales requirement or advertising budget requirement.[94] Additionally, Safe Step granted CKH the right to serve as the exclusive licensee in the outlined geographic area.[95] Furthermore, Safe Step required CKH to "vigorously promote" Safe Step products within its territory, maintain certain record keeping procedures, and keep Safe Step informed of market conditions.[96] CKH eventually claimed that a franchise relationship existed and that Safe Step had violated New York franchise law.[97] The court ultimately held that any state definition that uses "marketing plan" or "community of interest" to define a franchise is essentially including a control element, and, therefore, the minimum requirement of a marketing plan was met where these factors are present.[98]

H. *North Dakota*

North Dakota courts have issued little to no opinions interpreting the "marketing plan or system" element of its franchise statute.[99] However, in *Meadow Fresh Farms, Inc. v. Sandstrom*, which was an appeal from an order issued by the North Dakota Securities Commissioner that unregistered franchises were offered and sold by Meadow Fresh Farms in violation of the North Dakota Franchise Investment Law, the North Dakota Supreme Court held that a preponderance of evidence existed for the North Dakota Securities Commissioner to find a "marketing plan or system."[100] Namely, Meadow Fresh Farms provided (1) a detailed bonus structure for distributors; (2) centralized bookkeeping; (3) policies for distributor advancement; (4) assistance

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that when a licensor regulates virtually every aspect of a licensee's operation, then the licensor has satisfied the control requirements of a marketing plan.); *cf.* Nat'l Survival Game of N.Y., Inc. v. NSG of LI Corp., Bus. Franchise Guide ¶ 9294 (N.Y. Sup. Ct. Nov. 14, 1988) (finding no statutory marketing plan exists when a licensee operates their own business, independent of any licensor control, and is only required to make regular payments for the use of the licensor's name).

91. *See Safe Step*, 242 F. Supp. 3d at 257, 260 (citing 16 C.F.R. § 436.1(h) ("(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 . . . .")).

92. *See id.* at 251.

93. *Id.* at 252–53.

94. *Id.* at 252.

95. *Id.*

96. *Id.* at 261.

97. *Id.* at 251, 259 (CKH also claiming that Safe Step violated Connecticut, New, Jersey, and Rhode Island franchise laws).

98. *Id.* at 260.

99. N.D. Cent. Code § 51-19-02.

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

with customer meetings; (5) suggested prices; and (6) a comprehensive advertising program.[101]

I. *Oregon*

The case law interpreting what constitutes a franchise under the Oregon Franchise Transactions Law (OFTL) is limited but telling, as Oregon is one of the only states with a narrow view of this definitional element. In *Leonetti Furniture Manufacturing Co. v. Sealy, Inc.*, Leonetti sued for violation of the OFTL based on a license agreement between it and Sealy to manufacture and sell Sealy-Ohio mattresses.[102] Pursuant to the parties' license agreement, Leonetti was required to meet minimum sales goals, use its best efforts to sell Sealy-Ohio mattresses and maintain adequate production facilities, and Sealy-Ohio was allowed to inspect the production of Sealy-Ohio mattresses.[103] Further, there were even circumstances where Sealy-Ohio had discussions with Leonetti about the conduct of its salespeople.[104] However, these facts were not enough to sway the U.S. District Court for the District of Oregon in determining that no franchise relationship existed between the parties.[105] Specifically, Leonetti had failed to prove that the minimum control requirements were met.[106] Interestingly, the court noted that the Oregon statute was analogous to the control element under the FTC Rule.[107] Because the court determined that the parties' relationship did not fulfill the "control" FTC Rule element, the court did not need to specifically address the substance, or application, of the "marketing plan or system" element.[108]

J. *Tennessee*

Tennessee is the only state to create the definitional element "marketing plan" purely via case law without an underlying definition to interpret. Called upon to determine whether a manufacturer met its repurchasing requirement under the Tennessee Law for the Repurchase of Terminated Franchise Inventory (TRTFI), the Tennessee Supreme Court constructed its own definition of a "franchise" because the Tennessee legislators had not already done so.[109] In *Middle Tennessee Associates, Inc. v. Leeville Motors*, Middle Tennessee Associates (MTA) and Leeville Motors (Leeville) entered into a distribution agreement for gardening equipment.[110] When Leeville Motors fell behind on payments, MTA offered to repurchase the inventory subject to a fifteen percent restocking fee, less than what is required under the

101. *Id.* at 784–85.
102. *See* Leonetti Furniture Mfg. Co. v. Sealy, Inc., Bus. Franchise Guide ¶9,756, at p. 4 (D. Or. Oct. 16, 1990).
103. *Id.* at *11.
104. *Id.*
105. *Id.* at *30.
106. *Id.*
107. *Id.*
108. *Id.* at *10.
109. Middle Tenn. Assocs., Inc. v. Leeville Motors, 803 S.W.2d 206 (Tenn. 1991).
110. *Id.* at 208.

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TRTFI, prompting Leeville Motors' claim under the TRTFI.[111] Following other states' guidance set forth in a treatise on franchise contracts, the court held that a "franchise" exists when three elements are present, including "a franchisor who is engaged in the business of selling or distributing goods under a *marketing plan or system* devised and prescribed by the franchisor."[112] In so holding, the court overturned the appellate court decision, which had favored the purported franchisee, noting that "selling brand name merchandise does not make an independent dealer a franchisee," as the court was unable to identify any "marketing system."[113]

K. *Virginia*

Virginia, like many other states, has afforded its statute a broader reading of a "marketing plan or system," providing an expansive covered class of potential franchisees. At the regulatory level, the Virginia State Corporation Commission (VSCC) has held that a marketing plan or system exists where a licensor (ATC) granted a license to two licensees (Y&G and Triplex) to use the ATC name and provided the licensees with billing statements and training/promotional material to recruit new members.[114] Here, the VSCC instituted an investigation against ATC for violation of the Virginia Retail Franchising Act (VRFA).[115] Ultimately, the three-person panel of the VSCC found that ATC had offered and sold unregistered franchises in violation of the VRFA.[116] In response, ATC submitted a letter requesting reconsideration in connection with the determination due to the fact that ATC had received a letter from a staff member of the VSCC noting that its arrangement was not a franchise and that an internal investigation into the issue had ceased.[117] The VSCC determined that the record outlining ATC's conduct before and after receipt of the letter demonstrated a complete lack of reliance on the staff letter and upheld its decision.[118] The VSCC noted that it is not bound by the staff letter and that the staff member had delivered the staff letter after execution of one of the license agreements outlined above.[119] Ultimately, the VSCC required ATC to rescind the systems broker agreements and pay restitution to each of Y&G and Triplex (instead of payment to the Treasurer of Virginia).[120] Because the VSCC found a "marketing plan or system" where the franchisor merely provided optional billing statements and optional training/promotional material, this case represents one of the broadest constructions of the definition of a marketing plan or system.

111. *Id.*
112. *Id.* at 211 (emphasis added).
113. *Id.* (citing Lobdell v. Sugar 'N Spice, Inc., 658 P.2d 1267, 1271 (Wash. Ct. App. 1983)).
114. Commonwealth of Virginia *ex rel.* Y & G Co. and Triplex, Inc. v. Am. Trade Exchange, Inc., Case No. SEC870114, 1988 WL 1703284 (Va. State Corp. Comm'r Aug. 12, 1988).
115. *Id.*
116. *Id.*
117. *Id.*
118. *Id.*
119. *Id.*
120. *Id.*

Continuing this broad reading, the Virginia Supreme Court in *Crone v. Richmond Newspapers, Inc*. held that the VFRA applied to a distribution relationship where distributors were required to purchase a minimum amount of newspapers, deliver them to distribution points designated by the producer, RNI, and provide RNI with regular sales reports.[121] Furthermore, the distribution racks had to meet size, color, and logo requirements set by RNI.[122] The Virginia Supreme Court highlighted the legislators' express policy in passing the VRFA, namely "[to] correct inequities in the franchise system and to provide franchisees more direct, simple and complete judicial relief against franchisors who fail to deal in a lawful manner with them."[123] The court reversed and remanded the lower court decision in favor of RNI, holding that a franchise relationship did exist and that RNI could not terminate the relationship without reasonable cause.[124]

As evidenced by the results in *American Trade Exchange* and *Crone*, accidental and purposeful franchisors can be subject to consequences for violations of these state laws both at the regulatory level and the judicial level.

L. *Washington*

Washington outlines the factors that it will consider in determining whether a "marketing plan or system" exists under the Washington Franchise Investment Protection Act (FIPA). Specifically, those factors include "(a) price specifications, special pricing systems or discount plans; (b) sales or display equipment or merchandising devices; (c) sales techniques; (d) promotional or advertising materials or cooperative advertising; (e) training regarding the promotion, operation, or management of the business; or (f) operational, managerial, technical, or financial guidelines or assistance."[125]

In *Atchley v. Pepperidge Farm, Inc.*, the U.S. District Court for the Eastern District of Washington, on remand from the Ninth Circuit, held that a manufacturer has not prescribed a statutory marketing plan where it merely sets some distributor prices and guarantees an initial acquisition loan, but otherwise allows a distributor to operate independently.[126] The court noted that the control element was key to the existence of a "marketing plan."[127] An additional relevant factor is whether there is a provision of financial support or whether PFI audited the books of Atchley or inspected its premises.[128] Ultimately, the court did not find any of these control factors, in addition

121. *See* Crone v. Richmond Newspapers, Inc., 384 S.E.2d 78 (Va. 1989).
122. *Id*. at 79.
123. *Id*. at 78.
124. *Id*. at 81.
125. *See* Wash. Rev. Code. § 19.100.010(11).
126. Atchley v. Pepperidge Farm, Inc., No. CV–04–452–EFS., 2012 WL 6057130 (E.D. Wash. Dec. 6, 2012).
127. *See id.* at *8.
128. *Id*. at *14 (citing Hartford Elec. Supply Co. v. Allen-Bradley Co., 736 A.2d 824, 834 (Conn. 1999)).

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to any of the other elements of a "franchise" under FIPA, and held that no franchise relationship existed.[129]

M. *Wisconsin*

The Wisconsin Franchise Investment Act (WFIA) outlines the factors that it will consider in determining whether a "marketing plan or system" exists, including an agreement that (i) requires a distributor or licensee to purchase substantial portion of goods from sources approved by licensor; (ii) requires distributor or licensee follow an operating plan, standard procedure, or training manual or its substantial equivalent; (iii) requires distributor or licensee be limited as to the type, quantity and/or quality of any product or service the distributor or licensee may sell; (iv) limits which accounts or persons the licensee or distributor can sell to; (v) has termination or inventory buy-backs exercisable substantially at the will of the licensor; and (vi) requires that the licensor to assist the distributor or licensee in training, obtaining locations or facilities for operation of the franchisee's business or in marketing the franchisor's product or service.[130]

Contrary to Wisconsin courts' generally broad interpretation of the definition of a franchise under the Wisconsin Fair Dealership Law (WFDL),[131] which governs the *relationship* of two parties to a franchise agreement (as defined by the WFDL), the determinations under the WFIA are much narrower. For example, in *Otto v. Synthetic Surfaces*, the fact that a distributor was required to attend sales training provided by a manufacturer (subsection (vi) above), alone, was insufficient to fulfill the minimum requirements to establish the existence of a marketing plan and, in turn, a franchise relationship. [132] Namely, the court evaluated several of the other factors noted above in refusing to find a franchise relationship when a manufacturer put no limits on the customers a distributor could solicit and engage (subsection (iv) above), is not required to purchase most of its supplies from a specified supplier (subsection (i) above), and is not required to operate according to a plan laid out by a producer (subsection (ii) above).[133]

Again, starting on the regulatory side this time in *In the Matter of the KIS Corp.*, the Wisconsin Commissioner of Securities (WCS) found that a manufacturer (KIS) offered and sold unregistered franchises in violation of the WFIA.[134] KIS recommended, but did not require, the use of prices for products, and also offered an operational manual, sales kits, non-mandatory training, maintenance support, supplies, and participation in a cooperative

129. *Id.*, at *10.

130. *See* Wis. Admin. Code § 31.01(4)(a).

131. *See* Ziegler Co., Inc. v. Rexnord, Inc., 407 N.W.2d 873 (Wis. 1987) (rejecting a rigid rule and establishing two "guideposts" to use in determining existence of franchise relationships with respect to the definitional element "community of interest").

132. Otto v. Synthetic Surfaces, Inc. 103 Wis. 2d 693 (Ct. App. 1981).

133. *Id.* at *3.

134. *See generally In re* KIS Corp., No. F-86008(E), 1986 WL 1343366 (Wis. Comm'r of Secs. Dec. 24, 1986).

advertising program, which the WCS reasoned fulfilled the "marketing plan" definitional element.[135] While a "marketing plan" existed, but because it was not mandatory, the WCS held the parties' relationship did not fulfill the definition of a "franchise" under the WFIA.[136]

Courts and regulatory bodies may also consider whether the underlying agreement contains terms that require a licensee to purchase a substantial portion of goods solely from the licensor's designated sources.[137]

IV. (Marketing) Plan of Attack

As is always the case, planning and engagement to enable an attorney's thorough understanding of its client's business arrangements will help avoid the costly accidental franchise mistake at the state and federal level. Furthermore, an understanding of the legislative intent behind these state statutes (i.e., protecting franchisees who are presumably unable to effectively bargain with their franchisors) will help further the analysis. Before proceeding with a "franchise-adjacent" relationship, it is important that all licensors/distributors/grantors, and their attorneys, have a keen understanding of the nuances of the definitional elements of a franchise under each applicable statute. A "no franchise" disclaimer in an agreement is insufficient and will likely land your client in hot water. Furthermore, to franchise attorneys' detriment, as is the case with so many issues in the franchise industry, there is not one dispositive factor in a court's finding of a franchise relationship; oftentimes, it is the existence of several factors that result in the accidental or inadvertent franchise relationship. A recurring theme among accidental franchisors is a combination of the franchisor's provision of marketing/sales materials or sales techniques, pricing controls, and training. Based on the cases outlined in this article, a combination of those three factors will likely land unsuspecting businesses in the franchise industry whether they like it or not.

Attorneys counseling their clients on how to avoid the franchise designation in the states listed above must investigate each of the statutes' underpinnings, the legislative intent, and the factors considered by the applicable courts. Certain states call out those specific factors in the statute itself, while other simply do not. A careful reading, and implementation, of those factors can go a long way. Furthermore, any agreement should be carefully crafted with these factors in mind while always explaining the downside of avoiding the franchise designation; loss of control. Lastly, as is the case in most scenarios, companies must act in accordance with the terms of their agreements and avoid extending supervision and assistance beyond those words. Sometimes actions speak louder than words in finding a franchise relationship.

135. *Id*. (no pin cite available).

136. *Id*. (no pin cite available).

137. *See generally* Weiss v. Crazy Jim, No. 79-632, 1980 WL 99605, at *2 (Wis. Ct. App. Jan. 21, 1980) (citing Wis. Admin. Code DFI § 31.01(6)(b)).

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