

Message from the Publications Committee Chair, Fall 2009



Section Members:

In this Fall 2009 Section newsletter, we explore several recent developments in intellectual law. One article addresses the intersection of trademark licensing versus franchising highlights when a business relationship becomes a franchise. Another article addresses changes to Federal Trade Commission rules regarding use of endorsements and testimonials advertising, which expand coverage to include advertising messages in websites, blogs, social media. A third article discusses a recent decision regarding double patenting. A fourth discusses copyright issues in connection with the dispute between the maker of the Barbie and the maker of the Bratz® dolls.

We will continue to facilitate publication opportunities for our members. To that end, we encourage you to suggest topics that you would like to see discussed in future newsletters, and to let us know when you desire to write an article.

Sincerely,

Vasilios Peros
MSBA Intellectual Property Section

When Does Trademark Licensing Become Franchising?



By: David L. Cahn¹ and Jeffrey S. Fabian²

An issue that we often confront is determining whether a trademark license a franchisor wants to offer will be considered a franchise. Because franchising is a method of business expansion regulated by the Federal Trade Commission (“FTC”) and numerous state laws, including Maryland, whether a trademark license is, in fact, a franchise is of great importance in terms of the legal and accounting expenses required to offer the license. A careful and methodical analysis of a trademark licensing relationship’s structure and the flexibility it can determine whether it will constitute a franchise. While it is relatively easy to avoid the franchise definition in structuring a license for the sale of goods, including software, it is difficult to do so in licensing service marks.

The definition of a “franchise” varies from state to state; however, most definitions include three common elements, which appear in the Maryland Franchise Registration and Disclosure Law:

“Franchise” means an . . . agreement in which: (i) a purchaser is granted the right to engage in the offering, selling, or distributing goods or services under a marketing plan or system prescribed in substance 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. Md. Bus. Code § 201(e)(1).

Unless all three elements are present, the relationship will not be deemed a franchise under Maryland law. The benefits and protections of the disclosure and relationship laws will not apply. However, it is important to note that a small minority of states, including New York, only two of the elements are required for a relationship to be deemed a franchise.

The first element of the franchise definition requires that the franchisee be “prescribed” a “marketing plan” by the franchisor. Elements suggesting the existence of a marketing plan include: “(1) [p]rice specification . . . or discount; (2) Sales or display equipment or merchandising devices; (3) Sales techniques; (4) Promotional or advertising

(5) Training regarding the promotion, operation, or management of the business” COMAR § 02.02.08.02. In addition, the FTC has specified that, “restrictions on customers” and “location or sales area restrictions” are hallmarks of a franchise. FTC Informal Staff Advisory Opinion 98-4, Bus. Fran. Guide (CCH) ¶ 6493 (June 8, 1998); see also Rule Compliance Guide, 16 C.F.R. Part 436 (2008) at 2–3.

The analysis of prescription considers whether the parties’ agreement or the licensor’s representations suggest (1) that the franchisee follow an operating plan or training manual; (2) that the franchisee purchase a substantial quantity of its inventory or equipment solely from designated or approved suppliers; or (3) that the franchisee is limited as to quantity, or quality” of the products or services it sells. COMAR § 02.02.08.02.C.

The second element of the franchise definition requires that the franchisee’s business be substantially associated with the franchisor’s trademark. A business that identifies itself using a licensor’s trademark is clearly substantially associated with that mark. See *Grand Light & Supply Co., Inc. v. Honeywell, Inc.*, 771 F.2d 672, 677 (2d Cir. 1985); *Wright-McCormick Corp.*, 980 F.2d 432, 436 (7th Cir. 1992). However, if the licensee is not dependent on the licensor’s trademark for a substantial portion of its business, no franchise will exist. Compare *Hartford Electric Supply Co. v. Allen-Bradley Co.*, Bus. Fran. Guide (CCH) ¶ 11,685 (Conn. Sup. Ct. 1999) (substantial association found) with *Rudel Machinery Co. v. Lewis, Inc.*, Bus. Fran. Guide (CCH) ¶ 11,716 (D. Conn. 1999) (substantial association not found).

The third element is payment of a franchise fee. Maryland defines a franchise fee as any payment “required to . . . for the right to enter into a business.” Md. Bus. Reg. § 14-201(f)(1). The timing, method, number and amount of payments are virtually irrelevant. See COMAR § 02.02.08.03; see also *To-Am Equipment Co. v. Mitsubishi Forklift America, Inc.*, Bus. Fran. Guide (CCH) ¶ 11,456 (7th Cir. 1998) (purchase of \$1,600 in sales and services over many years constituted a franchise fee). Indirect or “hidden” franchise fees may be found to exist if the franchisor charges the franchisee above fair market value for equipment or inventory. *Bucciarelli v. National Insurance Co.*, Bus. Fran. Guide (CCH) ¶ 14,200 (E.D. Mich. 2009). However, payments amounting only to business expenses will not trigger the franchise definition. *Jon K. Morrison, Inc. v. Avis Rent-A-Car System, Inc.*, Bus. Fran. Guide (CCH) ¶ 12,701 (W.D. Wash. 2003).

Common questions considered in determining whether a payment constitutes a franchise fee include: (1) whether the payment is for an “unrecoverable investment”; and (2) whether the franchisee must put its own money at risk. See *Avis-Rent-A-Car System, Inc. v. Avis Rent-A-Car System, Inc.*, Bus. Fran. Guide (CCH) ¶ 12,702 (C.D. Cal. 2003) citing *Wright-Moore Corp. v. Wright-Moore Corp.*, 980 F.2d 432, 436 (7th Cir. 1992) (grantor’s deduction from independent salesperson’s commission constituted a franchise fee); compare *Lobdell v. Sugar ‘n’ Spice, Inc.*, 33 Wash. App. 881, 891–92, 658 P.2d 1267 (1983) (payment to a sales agent intended to recover training and marketing expenses constitute a franchise fee).

If these three elements are satisfied, the parties’ relationship constitutes a franchise, and it is governed by the Revised Franchise Rule and any applicable state relationship and disclosure laws. The broad definition of a franchise is intended to encompass the vast majority of “business format” licenses, and those who attempt to skirt the definition are treading on dangerous and uncertain ground. However, in appropriate circumstances, careful delineation of the parties’ rights and obligations in a proposed relationship can help manufacturers steer clear of the franchise realm.

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"Results Not Typical" - Bloggers and Celebrities (and Advertisers) Must Comply with New FTC Guides

By: Cynthia Blake Sanders[1]

Grass roots marketing just became a little less green. The Federal Trade

“ Bloggers must substantiate their claims in their posts. The Extreme Diet appearing in their posts.”