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**STRUCTURING SHARED SERVICES AND  
AFFILIATION PROGRAMS  
SUCH AS UBER AND CROSSFIT  
TO AVOID THE APPLICATION OF  
FEDERAL AND STATE FRANCHISE LAWS.**

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## I. INTRODUCTION

Franchising has long been a valuable method of business expansion. Franchisees provide capital and are responsible for the day-to-day operations of the business, allowing a company to expand at a faster rate than it could if it needed to provide its own capital and needed to select and supervise on-site managers for all of the locations. Additionally, a franchisee is often more motivated to succeed (and to cause the local outlet to succeed) than is an employee.

Despite these and other advantages, franchising is not always seen as an unmitigated force for good. Even some companies that have registered as franchises seem to have some ambivalence about the term, and refer to their agreements as “licenses” instead of “franchises”<sup>1</sup>

When even large, sophisticated franchisors are reluctant to fully embrace the “franchise” label, perhaps it should be no surprise that other companies considering expansion tell their lawyers that they do not want to be a franchisor. Not only does that lead to “non-franchise licenses,” it also has a tendency to create “hidden franchises” in which the true nature of the enterprise—and its satisfaction of the definitional elements of a franchise—are only established years later.<sup>2</sup>

As they have for some time, sophisticated companies (represented by sophisticated lawyers) have tried to craft new arrangements that are intended to avoid application of franchise laws; less sophisticated companies may simply proceed out of ignorance of the reach of franchise law. This paper discusses two broad categories of arrangements designed to avoid the reach of franchise laws—which we refer to as the “shared services” model and the “affiliation network” model—and whether these models are successful in avoiding application of franchise laws.

## II. NATURE OF THE SYSTEMS

### A. Technology–Platform-Based Shared Services Programs

The first type of business model that we discuss in this paper is something described by the promoters of these programs as “shared services.” As discussed in detail below, this is an arbitrary and perhaps even controversial term; the terminology in this area is (at best) rapidly shifting and (at worst) ambiguous or misleading.

Just as the terminology is controversial, we have been unable to identify an accepted universal definition of a shared services program. For our purposes, the common elements of all shared services business models addressed in this paper are: (a) a technology platform – such as a website or mobile app – operated by one party that (b) matches individuals who are offering goods or services with customers and clients seeking to acquire those goods or services, and (c) a payment mechanism intermediated through the technology platform that allows the operator of the technology platform to deduct a fee from the consumer’s payment before the provider is paid. There are many examples of these types of programs, including, for example,

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<sup>1</sup> See *Palazzetti Import/Export, Inc. v. Morson*, Bus. Franchise Guide [CCH] ¶ 11,757 (S.D.N.Y. 1999) (referring to a “license fee” instead of a “franchise fee” does not keep the agreement from satisfying the definition of a franchise).

<sup>2</sup> For a discussion of the “hidden franchise” issue, see, e.g., Kenneth R. Costello, Beata Krakus, & Kristy L. Zastrow, *From License Agreement to Regulated Relationships: The Accidental Franchise*, 32ND ANNUAL ABA FORUM ON FRANCHISING (2009).

Uber and Lyft which offer shared transportation services; Airbnb which offers shared housing; and Soothe which offers massages in the customer's home or office.

In order to intelligently address shared services, it is important to understand the historic use of the term, as well as controversy surrounding the term as applied to modern, consumer-facing technology platforms. Historically, the term "shared services" referred to organizational structures in which large companies consolidated "back office" functions across business units to try to garner economies of scale.<sup>3</sup> A conglomerate with multiple business units, each of which had its own support functions in areas such as human resources, information technology, purchasing, and the like, would combine these distributed activities into a shared services function that would provide those same functions to all of the business units. The goals of this combination were cost savings and greater expertise. Of course, one can argue that operations such as Uber or Airbnb can provide the same benefits of scale that corporate shared services provide. For example, a study conducted on behalf of the American Public Transportation Association found that persons who use services such as Uber or Lyft (in addition to more traditional public transportation options, such as buses and subways) own fewer cars per household than persons who just use traditional public transportation.<sup>4</sup> In this sense, describing these new businesses as shared services is logical, because they represent the same type of effort to achieve efficiency as the corporate shared services for which the name was first used.

But not everyone is happy about using this existing term for a new type of activity. One effort to distinguish businesses such as Uber and Airbnb from existing activities using the shared services name, whether traditional outsourcing models or consolidated back-office functions, has been to describe these newer computer-intermediated activities as part of the "sharing economy." This is another very broad term that can refer to any sharing of access to goods and services, including activities as informal as neighbors sharing garden tools, to more formal peer-to-peer sharing of agricultural equipment, to commercial activities such as self-service laundromats. Some of these activities are unpaid, while others are paid. When Lyft was first established, there was no "required" payment or fixed charge; rather, the service suggested a "donation" amount that the passenger could contribute to the driver (either in the amount originally suggested by the App or modified up or down in the discretion of the passenger). More recently, Lyft's model now prescribes a more-traditional "charge" for each ride.

Several commentators have said that the term "sharing economy" is also a misnomer when used for these types of services. For example, referring to house sharing, ride sharing, and peer-to-peer lending, one commentator said, "So what aspects of the sharing economy are not really about sharing? Having friends to stay over on a Saturday night is sharing. Handing them a bill with their breakfast makes me a hotelier. Giving somebody a lift is sharing. Charging them for it makes me a cabbie. Lending somebody a tenner until tomorrow is sharing. Charging them 6% interest for it is usury. None of these things are sharing, they are selling."<sup>5</sup>

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<sup>3</sup> *Shared Services*, WIKIPEDIA, THE FREE Encyclopedia, [https://en.wikipedia.org/wiki/Shared\\_services](https://en.wikipedia.org/wiki/Shared_services) (last accessed Sept. 8, 2016).

<sup>4</sup> *Shared Mobility and the Transformation of Public Transit*, AMERICAN PUBLIC TRANSPORTATION ASSOCIATION, <https://www.apta.com/resources/reportsandpublications/Documents/APTA-Shared-Mobility.pdf> (last accessed May 3, 2016).

<sup>5</sup> Rob Killick, *Sharing economy' companies like Uber and Airbnb aren't really 'sharing' anything*, INTERNATIONAL BUSINESS Times UK (Oct. 6, 2015), <http://www.ibtimes.co.uk/sharing-economy-why-pirate-capitalists-are-real-winners-1522676> (last accessed May 16, 2016).

Other commentators who argue that “sharing economy” is a misnomer say that the correct term for this activity is “access economy.” According to the authors of an article in the *Harvard Business Review*, “When ‘sharing’ is market-mediated — when a company is an intermediary between consumers who don’t know each other — it is no longer sharing at all. Rather, consumers are paying to access someone else’s goods or services.”<sup>6</sup>

Our purpose here is not to debate the terminological niceties of the name used for these activities. Despite the potential shortcomings or inaccuracy of the terminology, for purposes of this paper, we will use the following terms:

- “shared services” will refer to the technology-mediated programs that match goods and services with customers in the manner discussed above;
- “platform company,” will refer to the company that operates the technology platform (in many cases, an App such as Lyft or Airbnb);
- “provider” will refer to the person that offers services (such as a driver for Lyft or a homeowner with Airbnb); and
- “customer” will refer to the person who uses the services (such as a passenger for Lyft or a renter for Airbnb).

This paper will analyze whether and when the platform company may be a franchisor, and the provider may actually be a franchisee.

## **B. Affiliation Network Programs<sup>7</sup>**

If shared services are an ill-defined sector of the economy, the businesses describing themselves as affiliation networks are perhaps even more varied, and include everything from referral networks to organizations that could well fall within the parameters of franchises.

Examples that may be familiar to many lawyers include Lex Mundi and the Pacific Rim Advisory Council (“PRAC”). Lex Mundi provides law firms with an international network of firms to consult with and to refer business. As Lex Mundi’s website explains, “Lex Mundi members are not affiliated in the joint practice of law; each member firm is an independent law firm and renders professional services on an individual and separate basis.”<sup>8</sup> As Lex Mundi describes the relationship:

Each member firm is selected on the basis of its leadership in—  
and continued commitment to—its local market. Our principle is

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<sup>6</sup> Giana M. Eckhardt & Fleura Bardhi, *The Sharing Economy Isn’t About Sharing at All*, HARVARD BUS. REV. (Jan. 28, 2015), <https://hbr.org/2015/01/the-sharing-economy-isnt-about-sharing-at-all> (last accessed May 16, 2016).

<sup>7</sup> This should not be confused with “affiliate programs,” which are technology-intermediated advertising programs whereby manufacturers and retailers reward third parties for promoting their brand, their goods, or their services. With an affiliate program, a content provider—an app, game, website, or blogger—links in some manner to a site that sells a product or service. The content provider then receives a commission in some form from the sales made from its link. Many (if not most) online sales platforms can offer an “affiliate program,” including Amazon.com, iTunes, and Microsoft. Such affiliate programs generally lack the core components of franchising, as they generally do not include any payment that could be called a franchise fee, substantial control over the content provider’s content, or a marketing plan.

<sup>8</sup> <http://www.lexmundi.com/lexmundi/default.asp> (last accessed July 21, 2016).

one independent firm for each jurisdiction. Firms must maintain their level of excellence to retain membership within Lex Mundi.

Through close collaboration, information-sharing, training and inter-firm initiatives, the Lex Mundi network is an assurance of connected, on-the ground expertise in every market in which a client needs to operate. Working together, our members are able to seamlessly handle their clients' most challenging cross-border transactions and disputes.<sup>9</sup>

Lex Mundi Member firms retain their own brand identity. Some display the Lex Mundi logo on their website, but others do not.<sup>10</sup> PRAC operates in a similar manner.<sup>11</sup>

Another well-known brand that describes itself as an "affiliation network" is CrossFit, Inc. ("CrossFit"). As discussed in a 2014 *Franchise Law Journal* article, *Certification Programs: Franchises Or Not?*<sup>12</sup> CrossFit describes itself as "a fitness regimen" and certifies instructors in its fitness discipline.<sup>13</sup> To earn a certified CrossFit trainer designation, candidates must complete a CrossFit course, pass a written multiple-choice test, and pay a fee, which entitles them to be identified on CrossFit's "Trainer Directory," and promote themselves as "Certified CrossFit Trainers," but forbids the use of CrossFit in their business name.<sup>14</sup> Certified CrossFit trainers can apply to become "CrossFit affiliates," which allows them to license the CrossFit mark for \$3,000 per year and use "CrossFit" in a business name, such as "CrossFit West End."<sup>15</sup> CrossFit affiliates must carry minimum insurance, link their websites to the licensor's blog, adhere to the CrossFit philosophy, and use CrossFit's training methods; but there are no particular trade dress requirements for affiliate-owned gyms, and affiliates may set their own rates.<sup>16</sup> In the past, CrossFit offered affiliates optional location selection and marketing support services.<sup>17</sup> It is not clear that it currently does so. However, its current website states CrossFit will link to affiliate websites from the main page of CrossFit.com, and that affiliates will "have access to the private Affiliate Forum on the CrossFit Message Boards."<sup>18</sup> Similarly, prior to the publication of the *Franchise Law Journal* article, CrossFit's website bluntly stated that its programs are not franchises, describing CrossFit instead as "a confederation of legitimate fitness practitioners pooling reliable resources."<sup>19</sup> Its current website removes that language, instead describing affiliation as

<sup>9</sup> [http://www.lexmundi.com/lexmundi/About\\_Lex\\_Mundi.asp](http://www.lexmundi.com/lexmundi/About_Lex_Mundi.asp) (last accessed July 21, 2016).

<sup>10</sup> See, e.g., [www.maynardcooper.com/](http://www.maynardcooper.com/) (last visited July 11, 2016) (displaying the Lex Mundi logo); [www.mofo.com](http://www.mofo.com) (last visited July 11, 2016) (not displaying the Lex Mundi logo).

<sup>11</sup> See generally, <http://www.prac.org/> (last accessed July 13, 2016).

<sup>12</sup> Rochelle B. Spandorf, Jennifer L. Brockett, Anna R. Buono, *Certification Programs: Franchises Or Not?*, 33 *FRANCHISE L. J.* 505 (Spring 2014).

<sup>13</sup> <https://www.crossfit.com/what-is-crossfit> (last accessed Aug. 5, 2016).

<sup>14</sup> [https://assets.crossfit.com/pdfs/certifications/CCFT\\_CandidateHandbook.pdf](https://assets.crossfit.com/pdfs/certifications/CCFT_CandidateHandbook.pdf) (last accessed Aug. 5, 2016).

<sup>15</sup> <https://affiliation.crossfit.com/how-to-affiliate> (last accessed Aug. 5, 2016).

<sup>16</sup> *Id.*

<sup>17</sup> Spandorf, Brockett & Buono, *supra* note 12, at 518.

<sup>18</sup> <https://affiliation.crossfit.com/how-to-affiliate> (last accessed Aug. 5, 2016).

<sup>19</sup> Spandorf, Brockett & Buono, *supra* note 12, at 518.

“an Internet-based, grassroots movement started by CrossFitters who wanted their own local CrossFit-equipped gyms, trainers, and communities.”<sup>20</sup>

For purpose of this article, we will refer to these types of affiliation or licensing networks as an “affiliation network,” and to its licensees as “members.”

### III. APPLICATION OF FRANCHISE DISCLOSURE AND REGISTRATION LAWS

The precise language of federal<sup>21</sup> and state<sup>22</sup> definitions of a “franchise” varies slightly, but, generally, the following three elements must be satisfied in order to be a “franchise”: a common identification (or “trademark”) element, a “control” element, which is described in a variety of ways but generally requires a degree of interrelationship between the “franchisor” and “franchisee” (sometimes described as the “community of interest,” “marketing plan,” or “control or assistance” element), and a “fee” element. For purposes of this paper, general familiarity with these elements is assumed, and the focus is on how the elements are applied in the specific circumstances of shared services and affiliation networks.<sup>23</sup>

Also, since there are a myriad of agreements in each of the “shared services” and “affiliation network” categories, and these agreements are regularly revised and updated by the pro-

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<sup>20</sup> <https://affiliate.crossfit.com/> (last accessed Aug. 5, 2016).

<sup>21</sup> Disclosure Requirements and Prohibitions Concerning Franchising, 16 C.F.R. § 436 (2007) (“FTC Franchise Rule”).

<sup>22</sup> Alaska Distributorships Law, Alaska Stat. § 45.45.700 *et seq.*; Arkansas Franchise Practices Act, Ark. Code Ann. § 4-72-201 *et seq.*; California Franchise Investment Law, Cal. Corp. Code § 31000 *et seq.*; California Franchise Relations Act, Cal. Bus. & Prof. Code § 20000 *et seq.*; Connecticut Trading Stamps, Mail Order, Franchises, Credit Programs, Subscriptions Act, Conn. Gen. Stat. § 42-133e *et seq.*; Delaware Franchise Security Law, Del. Code Ann. tit. 6, § 2551 *et seq.*; Hawaii Franchise Investment Law, Haw. Rev. Stat. § 482-E1 *et seq.*; Illinois Franchise Disclosure Act, Ill. Comp. Stat. § 705/1 *et seq.*; Indiana Franchises Law, Ind. Code § 23-2-2.5-1 *et seq.*; Indiana Deceptive Franchise Practices Law, Ind. Code § 23-2-2.7-1 *et seq.*; Iowa Franchise Act, Iowa Code § 523.H.1 *et seq.*, and § 537.A.10; Maryland Franchise Registration and Disclosure Law, Md. Code Ann., Bus. Reg. § 14 201 *et seq.*; Michigan Franchise Investment Law, Mich. Comp. L. § 445.1501 *et seq.*; Minnesota Franchises Statute, Minn. Stat. § 80C.01 *et seq.*; Mississippi Pyramid Sales Scheme Act, Miss. Code Ann. § 75-24-51 *et seq.*; Missouri Pyramid Sales Scheme Act, Mo. Rev. Stat. §§ 407.400 *et seq.*; Nebraska Franchise Practices Act, Neb. Rev. Stat. § 87-401 *et seq.*; New Jersey Franchise Practices Act, N.J. Rev. Stat. § 56-10-1 *et seq.*; New York State Franchise Act, N.Y. Gen. Bus. Law § 680 *et seq.*; North Dakota Franchise Investment Law, N.D. Cent. Code § 51-19-01 *et seq.*; Oregon Franchise Transactions Law, Ore. Rev. Stat. § 650.005 *et seq.*; Puerto Rico Dealers’ Contracts Act (a/k/a/ “Law 75”), P.R. Laws Ann. tit. 12A, § 278 *et seq.*; Rhode Island Franchise and Distributorship Investment Regulations Act, R.I. Gen. Laws § 19-28.1-1 *et seq.*; Rhode Island Fair Dealership Act, R.I. Gen. Laws § 6-50-1 *et seq.*; South Dakota Franchises for Brand-Name Goods and Services Law, S.D. Codified Laws § 37-5B-1 *et seq.*; Utah Consumer Sales Practices Act, Utah Admin. Code R152-11-11; Virgin Islands Franchise Business Act, V.I. Code Ann. tit. 12A, § 130 *et seq.*; Virginia Retail Franchising Act, VA. Code Ann. § 13.1-557 *et seq.*; Washington Franchise Investment Protection Act, Wash. Rev. Code § 19.100.010 *et seq.*; Wisconsin Franchise Investment Law, Wis. Stat. § 553.01 *et seq.*; Wisconsin Fair Dealership Law, Wisc. Stat. § 135.01 *et seq.*

<sup>23</sup> Much of the scholarship on what constitutes a franchise comes in the context of discussions of the “hidden” or “accidental” franchise problem. For example, see Rochelle B. Spandorf and Mark A. Kirsch, *Accidental Franchise*, 25TH ANNUAL ABA FORUM ON FRANCHISING (2001); James R. Sims III and Mary Beth Trice, *Hidden Franchises*, ABA FORUM ON FRANCHISING (Oct. 22-24, 1997); see also Ann Hurwitz and David W. Oppenheim, *You Don’t Want To Be a Franchise? Structuring Business Systems not to Qualify As Franchises*, 35TH ANNUAL ABA FORUM ON FRANCHISING (2011).

vider,<sup>24</sup> we will focus less on the language of any particular agreement, and more on the concepts represented by these types of agreements.

## A. Trademark Element

The first element of the definitions of a franchise is that the franchised business must be “identified or associated with,”<sup>25</sup> or “substantially associated with”<sup>26</sup> a trademark,<sup>27</sup> or the franchisor must have granted the right to use the trademark,<sup>28</sup> or the franchisee must be “using” the trademark.<sup>29</sup>

### 1. Required Use of the Mark

In some of the shared services businesses, the association with a trademark seems relatively straight-forward. Drivers for Uber display one of the registered Uber trademarks (originally, a stylized “U” in a rounded square; more recently a circle with square in the center) inside their windshields, and drivers for Lyft also display some sort of identification (originally, a pink “carstache”—a furry, pink mustache attached to the car’s grill—or a “glowstache”—a light-up pink mustache suspended from the rear-view mirror; more recently, a pink sign with the word “Lyft” in stylized letters). Therapists for Soothe wear shirts bearing the Soothe trademark. Similarly, there is a wide variety of use of marks in affiliation networks. For example, CrossFit-affiliated gyms and Lex Mundi-member law firms may display the licensed mark, but are not required to do so.

In those shared services systems and affiliate networks in which the provider or member displays the platform company’s trademark with the express or implied permission of the platform company, all versions of the trademark test are satisfied. In fact, the FTC (in its Compliance Guide<sup>30</sup>) says that “the right to use the franchisor’s mark in the operation of the business ... by selling goods or performing services identified with the mark ... is an integral part of franchising.”<sup>31</sup> By the same token, in *American Business Interiors, Inc. v. Hawarth, Inc.*,<sup>32</sup> the court found that the grant to a furniture dealer of a right to identify itself in advertising as an authorized

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<sup>24</sup> See, e.g., *Mohamed v. Uber Technologies*, No. 15-16178, \_\_\_\_ F.3d \_\_\_\_, 2016 WL 4651409 (9th Cir. Sept. 7, 2016), noting that the plaintiff’s contract with Uber was updated in 2012, 2013 and 2014 as a condition of his continued use of the Uber app.

<sup>25</sup> FTC Franchise Rule and South Dakota Franchises for Brand-Name Goods and Services Law.

<sup>26</sup> Most state franchise sales laws (see, for example, California Franchise Investment Law and New York laws) and a few franchise relations laws (see, for example, Connecticut and Iowa laws).

<sup>27</sup> See the discussion in Daniel J. Oates, Shannon L. McCarthy, & Douglas C. Berry, *Substantial Association with a Trademark: A Trap for the Unwary*, 32 FRANCHISE L. J. 3 (Winter 2013).

<sup>28</sup> Hawaii Franchise Law, Haw. Rev. Stat. § 482-E1 *et seq.*

<sup>29</sup> Minnesota Franchises Statute, Minn. Stat. § 80C.01 *et seq.*

<sup>30</sup> See *FTC Franchise Rule Compliance Guide*, <https://www.ftc.gov/system/files/documents/plain-language/bus70-franchise-rule-compliance-guide.pdf> (last accessed May 25, 2016).

<sup>31</sup> *Id.* at 2.

<sup>32</sup> 798 F.2d 1135 (8th Cir. 1986), applying Missouri law.



dealer of the manufacturer's products by using the manufacturer's trademarks was sufficient to satisfy the Missouri franchise relationship law's requirement that the franchisor "grants to another person a license to use a ... trademark."

But the connection between the trademarks owned by a platform company or affiliation network, on the one hand, and the goods or services delivered by a provider or a member is not always as clear. In the case of shared services, people renting out a couch, a room, or a house through Airbnb do not display any sort of trademark on the couch, room, or house that they are making available for use. In fact, some platform companies may not license (or may even prohibit) the provider from displaying the trademarks of the platform company. By the same token, the degree to which members in affiliation networks may display the network logo may vary considerably. While the authors have been unable to identify any affiliation network that completely bars the use of its mark, this may be a result of such bars, rather than a decision by the members not to display marks they are contractually allowed to display. Under the FTC Franchise Rule (which uses the "identified by or associated with" formula for the trademark element), the FTC has said that "a supplier can avoid [FTC] Rule coverage of a particular distribution arrangement by expressly prohibiting the distributor from using its mark."<sup>33</sup>

Similarly, at least some affiliation networks describe themselves as certification programs rather than franchises,<sup>34</sup> possibly in an effort to take advantage of an exemption written into the original 1979 FTC Franchise Rule. A true "certification program," however, is exempt from the FTC Franchise Rule. Section 436.2 of the 1979 Franchise Rule excluded four types of relationships from regulation under that rule: (1) employer-employee or general partnership relationships; (2) relationships created by membership in a bona fide cooperative association; (3) agreements "for the use of a trademark, service mark, trade name, seal, advertising, or other commercial symbol designating a person who offers on a general basis, for a fee or otherwise, a bona fide service for the evaluation, testing, or certification of goods, commodities, or services"; and (4) "single license" relationships.<sup>35</sup>

Three decades later, when the FTC amended the 1979 Franchise Rule in 2007, it intentionally omitted all four definitional exclusions. In its Statement of Basis and Purpose (2007 SBP) accompanying the 2007 Amended Rule, the FTC stated that removing the exclusions from the definition of a franchise neither changed the scope of "franchise" nor extended coverage to previously excluded relationships; rather, the FTC explained that the exclusions were well-established, and eliminating the references would "streamline the Rule."<sup>36</sup>

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<sup>33</sup> See FTC Franchise Rule, *supra* note 30, at p. 2.

<sup>34</sup> See Spandorf, Brockett, and Buono, *supra* note 12.

<sup>35</sup> Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, 44 Fed. Reg. 49,990 (codified at 16 C.F.R. § 436.2(a)(4)).

<sup>36</sup> Proposed Franchise Rule, 64 Fed. Reg. 57,294, 57,319-20 (1999) ("The Commission believes that these exclusions no longer serve a useful purpose. Although there may have been some confusion about the extent of Rule coverage at the time the Commission promulgated the Franchise Rule nearly twenty years ago, the Commission believes that such confusion does not exist today. Since the Rule went into effect in the 1970s, the franchise community has become very familiar with the Rule's requirements, including the definition of the term franchise. In eliminating the four exemptions [sic], however, the Commission is not signaling a substantive change in Commission policy. Rather, the elimination of the exclusions is simply part of the Commission's general effort to streamline the Rule.").

In addition, a certification program generally does not meet the trademark element under any state test.<sup>37</sup> This is because a true “certification program” grants the provider or member the right to use a *certification* mark. A certification mark is fundamentally different from a trademark, and governed by different provisions of the Lanham Act.

Although certification marks and trademarks both serve to distinguish goods and services, a certification mark “is a special creature created for a purpose uniquely different from that of an ordinary service mark or trademark ....”<sup>38</sup> A certification mark is:

any word, name, symbol, or device, or any combination thereof—  
(1) used by a person *other than its owner*, or (2) which its owner has a bona fide intention to permit a person *other than the owner* to use in commerce and files an application to register on the principal register established by this chapter, to certify regional or other origin, material, mode of manufacture, quality, accuracy, or other characteristics of such person’s goods or services or that the work or labor on the goods or services was performed by members of a union or other organization.<sup>47</sup>

Thus, while trademarks or service marks identify a particular *source* of a product or service,<sup>39</sup> certification marks signify a particular characteristic of goods or services, *irrespective* of the source.

Certification marks and traditional trademarks advance different public policies.<sup>40</sup> Although certification marks and trademarks both operate to reduce consumer confusion and aid purchasing decisions, unlike trademarks, certification marks protect the “public interest in free and open competition among producers and distributors of the certified product.”<sup>41</sup>

There are two other critical differences between certification marks and trademarks. First, under the Lanham Act definition, a true certification mark “may not be used, in the trademark sense of ‘used,’ by the owner of the mark; it may be used *only* by a person or persons *other than the owner* of the mark.”<sup>42</sup> In other words, the owner of the mark does not—and cannot—apply the certification mark to its own goods or services.<sup>43</sup> Instead, the certification mark owner must authorize others to apply the mark to their qualifying goods and services. Thus, un-

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<sup>37</sup> See *id.* at 507-508.

<sup>38</sup> *In re Florida Citrus Comm’n*, 160 U.S.P.Q. 495, 499 (T.T.A.B. 1968).

<sup>39</sup> *Qualitex Co. v. Jacobson Prods. Co.*, 514 U.S. 159, 163-64 (1995).

<sup>40</sup> *Idaho Potato Comm’n v. M&M Produce Farms & Sales*, 335 F.3d 130, 138 (2d Cir. 2003).

<sup>41</sup> *Id.*

<sup>42</sup> Trademark Manual Of Examining Procedure, 38, § 1306.01(a) (emphasis added).

<sup>43</sup> The owner of the mark can, however, use “its certification mark in advertising or promoting recognition of the certification program or of the goods or services meeting the certification standards of the registrant.” 15 U.S.C. § 1064 (2006). “[S]o long as the registrant does not itself produce, manufacture, or sell any of the certified goods or services to which its identical certification mark is applied,” the mark is not subject to cancellation on the basis of using the mark for promoting the certification program. *Id.*

like a trademark or service mark that indicates a specific commercial or proprietary source, a certification mark is used on the goods or services of many different producers.

Second, a certification mark must be licensed to any and all who qualify. As the Second Circuit explained in *Idaho Potato Commission v. M & M Produce Farm & Sales*, an opinion joined by now-Justice Sandra Sotomayor:

Significantly, trademark owners are granted a monopoly over their marks and can choose to license the marks to others on whatever conditions they deem appropriate, so long as confusion does not result. The same is not true of certification marks. Certification mark licensing programs are a form of limited compulsory licensing, and the certifier has a duty ... to certify the goods or services of any person who meets the standards and conditions which the mark certifies. That the owner of a certification mark cannot refuse to license the mark to anyone on any ground other than the standards it has set, is an important distinction between the policies embodied in trademarks and certification marks.<sup>44</sup>

As a result, while some licensors may avoid franchising requirements by setting up a certification program, this is not a model that will appeal to everyone.

## **2. Absence of the Mark on Underlying Goods or Services**

The non-display of a trademark by the provider or member is not *necessarily* fatal to satisfaction of the trademark element under all formulations of the trademark element, especially in those states using the “substantially associated” test for trademark usage. There is another way in which the trademark owned by the platform company and the services offered by the provider (or the trademark owned by the affiliate network and the services offered by the member) are related even if the provider or member does not display any of the marks owned by the platform company. Specifically, the customer desiring to use one of the shared services, such as a person desiring to rent a room on Airbnb, or the customer desiring to obtain services from a member of an affiliate network may first go to a website or an App operated by the platform company or affiliate network. That website or App is itself almost invariably identified with the trademark belonging to the platform company or affiliate network.

A case from California (which uses the “substantial association” test for the trademark element) is instructive in this regard. *Kim v. Servosnax*,<sup>45</sup> involved the operation of unbranded “industrial” cafeterias in office buildings and other commercial facilities. Servosnax (the putative franchisor) entered into agreements with building owners for the operation of the cafeterias, then subcontracted the actual operations of the cafeterias to third parties. These third parties were prohibited from using any of the trademarks belonging to Servosnax. Nonetheless, the court held that the prime contract between Servosnax and the building owners would not have been established absent the reputation and goodwill inherent in Servosnax’s mark, and that therefore the subcontracts with the individual operations carried a substantial association with the marks even though the individual operators were prohibited from using or displaying the

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<sup>44</sup> 335 F.3d 130, 138 (2d Cir. 2003) (citations and internal quotations omitted).

<sup>45</sup> 10 Cal. App. 4th 1346 (1992).

Servosnax marks themselves.<sup>46</sup> In those jurisdictions following the substantial association model for the trademark element, use of the trademarks on the website or App of the platform company or affiliate network could satisfy this element, even if the providers or members do not use (or are prohibited from using) the marks.

## **B. Control Element**

The greatest variation in the definitions of a franchise in the various franchise laws appears in the control element. There are three different versions of the control test. The FTC Franchise Rule and the South Dakota Law provide that a franchise exists when 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.”<sup>47</sup> Most state laws provide that a franchise only exists if there has been a “grant of a right to offer goods or services under a marketing plan or system prescribed in substantial part by the franchisor.”<sup>48</sup> But a few states provide that a franchise exists only when “the franchisor and franchisee have a community of interest in the marketing of goods or services at wholesale, retail, by lease, agreement, or otherwise.”<sup>49</sup> We will discuss each of these versions of the control element below, along with some of the more-common factors likely to appear in shared services agreements or affiliation network agreements that may satisfy these requirements.

### **1. FTC Test (Significant Control or Assistance)**

Only the FTC Franchise Rule and the South Dakota Law use the “significant control or assistance” definition for the control element of the definition of a franchise. Because there is no private right of action under the FTC Franchise Rule, and very few court cases have been brought by the FTC to enforce the Rule, most of the guidance on this version of the element comes from the Compliance Guide issued by the FTC<sup>50</sup> and (to a lesser extent) the Statement of Basis and Purpose (the “SBP”) issued by the FTC at the time it issued the FTC Franchise Rule, as well as Advisory Opinions interpreting the FTC Franchise Rule.<sup>51</sup> One particularly interesting note in the SBP was a response to a comment by the late John Baer (and others) that the FTC should “adopt the states’ definition of the term ‘franchise.’” The FTC responded that “there is no single state definition of the term ‘franchise’ ... [but] the Rule’s definition is entirely consistent with the principles underlying the various state definitions.”<sup>52</sup> Although not expressly stated as such, this seems to be a hint that the FTC will look to cases and other guidance issued in connection with state law definitions in construing the FTC Franchise Rule, even though the language used is different.

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<sup>46</sup> *Id.* at 1358-1359.

<sup>47</sup> See note 30, *supra*, and Section III.B.1, below.

<sup>48</sup> See Section III.B.2, below.

<sup>49</sup> See Section III.B.3, below.

<sup>50</sup> See note 30, *supra*.

<sup>51</sup> 72 Fed. Reg. 175444, *et seq.* (Mar. 30, 2007).

<sup>52</sup> *Id.* at 15460 (footnotes omitted).

The Compliance Guide observes that “[t]he more franchisees reasonably rely upon the franchisor’s control or assistance, the more likely the control or assistance will be considered ‘significant’ and that franchisees are likely to reasonably rely on the franchisor’s control or assistance if the control or assistance is unique to that specific franchisor, as opposed to a typical practice employed by all businesses in the same industry.”<sup>53</sup> The Compliance Guide lists a number of types of controls that are likely to be considered significant including site approval, hours of operation, and restrictions on customers, a number of types of assistance that are likely to be considered significant, such as formal training programs, furnishing management advice, and furnishing a detailed operating manual, and a number of “lesser” controls or assistance that *may be* considered significant, but presumably are not significant individually, such as inventory controls and on-the-job assistance.<sup>54</sup>

In Advisory Opinion 04-4,<sup>55</sup> the FTC addressed whether a network established to help glass installers compete for the insurance segment of the auto glass replacement market was a franchise. The affiliation network imposed minimal quality standards. The installer had to be accredited by an independent agency, meet all procedures concerning adhesives, provide a materials and workmanship warranty to their customers, use only new glass in replacing windshields, repair rather than replace windshields whenever possible, have a fixed location, carry minimum insurance, comply with all laws and regulations, be open certain minimum hours, and retain certain records. According to the FTC, these quality standards, coupled with the assistance provided by the network were sufficient control to establish a franchise relationship. On the other hand, the FTC has also made clear that “promotional activities intended to help the distributor in making sales,” “trademark controls designed solely to protect the trademark owner’s legal ownership rights to the mark,” and “health or safety restrictions required by the law,” do not give rise to a franchise relationship.<sup>56</sup>

In the universe of shared services agreements and affiliation networks, there are a variety of different circumstances, with differing degrees of control and assistance provided by the platform companies to the providers. Putting aside the issue of whether the FTC will construe its definition of a “franchise” in a manner to be consistent with state law definitions of franchises, the only example of a significant control or an item of significant assistance in the examples provided by the FTC that seems to apply (more or less) universally to shared services agreements and affiliate networks is “furnishing system-wide networks and website.”<sup>57</sup> The shared services arrangements that we discuss in this paper all involve a technological platform (website or App) through which the customer interacts with the platform company, the provider, or both. Additional indicia of significant control or assistance mentioned by the FTC in its Compliance Guide such as “promotional campaigns requiring franchisee participation or financial contribution” and “locale or area of operation” may apply to some of the shared services businesses.<sup>58</sup> The remaining items of significant control or assistance identified by the FTC in its Compliance

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<sup>53</sup> FTC Compliance Guide, note 30, *supra*, at p. 2.

<sup>54</sup> *Id.* at 3-4.

<sup>55</sup> Bus. Franchise Guide (CCH) ¶ 6524, Nov. 8, 2004.

<sup>56</sup> Federal Trade Commission, Franchise Rule Compliance Guide, at p. 4.

<sup>57</sup> *Id.*

<sup>58</sup> *Id.*

Guide do not apply to any shared services systems with which the authors are familiar. Similarly, the affiliate networks all have a website through which potential customers can find members of the affiliate network (although some members of the affiliate networks also have their own, individual, websites).

It is not clear if these common websites alone (or, in the case of shared services models, in combination with a technological platform, without more) is sufficient to constitute “significant assistance,” or if additional controls or assistance must be shown.

With affiliate networks, there generally does seem to be more than just the common website, but it is not clear if these additional requirements rise to the level of significant controls or significant assistance. Lex Mundi, for example, seems to impose only generic requirements, requiring that its members “provide excellent service,” maintain “up to date” websites, use software “compatible with technology generally used by the legal industry,” and promptly respond to inquiries from member firms.<sup>59</sup> These all seem to be very minimal requirements. CrossFit affiliates, however, must carry minimum insurance, link their website to the licensor’s website, adhere to the CrossFit philosophy, and use CrossFit’s training methods; at least at one time, they were also allowed to participate in optional location selection and marketing support services.<sup>60</sup> This appears much closer to the scenario set out in Advisory Opinion 04-4, where the FTC found that the “control” element had been satisfied. Affiliation networks wishing to avoid franchisor status should carefully compare whether their activities, like the auto glass replacement network discussed in Advisory Opinion 04-4, cross over the line into control.

## 2. State Law (Marketing Plan)

Most of the states that have franchise sales laws describe the control element as the grant of a right to offer goods or services under a marketing plan or system prescribed in substantial part by the franchisor. While a traditional dictionary definition of “prescribe” is “to lay down authoritatively” or “to dictate,”<sup>61</sup> case law has sometimes interpreted “prescribe” in a manner that emphasizes which party has the right to establish the marketing plan or system, rather than focusing on whether there is any flexibility in the plan. In some states, courts have found the marketing plan element satisfied if the franchisor is allowed to establish the marketing plan or system itself, without input or agreement from its franchisees. For example, in *To-Am Equipment Co. v. Mitsubishi Caterpillar Forklift America, Inc.*,<sup>62</sup> the court held that the equipment manufacturer was not required to force its dealer to follow the suggested advertising and marketing plans to find that the plans had been *prescribed* by the manufacturer. Similarly, in *Blankenship v. Dialist International Corp.*,<sup>63</sup> the court stated that the test was not the franchisee’s mandatory use of the marketing plan, but rather the right of the franchisee to sell using the marketing plan that had been established by the franchisor.

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<sup>59</sup> [http://www.lexmundi.com/lexmundi/Service\\_Standards.asp](http://www.lexmundi.com/lexmundi/Service_Standards.asp) (last checked July 18, 2016).

<sup>60</sup> See Section II.B., *supra*.

<sup>61</sup> Black’s Law Dictionary, West Publishing Co. (6th Ed. 1990).

<sup>62</sup> 953 F. Supp. 987 (N.D. Ill. 1997), *aff’d* 152 F3d 658 (7th Cir. 1998).

<sup>63</sup> 568 N.E.2d 503 (Ill. App. 1991).

But it is not universally true that delivery of a plan suffices if use of that plan is optional and not required. In *Matter of the KIS Corporation*,<sup>64</sup> an Administrative Law Judge in the office of the Wisconsin Commissioner of Securities held that mere suggestions do not satisfy the requirement of a marketing plan unless either penalties could be imposed for failure to follow the plan or the practical reality was that the franchisee did not have unrestricted autonomy in the operation of the business. Similarly, in *Commonwealth of Virginia v. American Trade Exchange, Inc.*,<sup>65</sup> the Virginia State Corporation Commission upheld (in *dicta*) the staff's position that "prescribed" in the Virginia law means "required," but found that the franchisor in that case did require compliance with a marketing plan because (among other factors) the franchisor assigned exclusive territories, prepared the billing statements, and kept the original contracts between the franchisees and the franchisees' customers.

As for what constitutes a "marketing plan," there is some inconsistency in the treatment of this factor, with some precedents requiring (or at least suggesting) that a comprehensive set of guidelines is necessary, while other precedents indicate this factor can be satisfied by much more-limited guidance.

The franchise laws and regulations in Illinois, Rhode Island, and Washington provide guidance on what constitutes a marketing plan. The Illinois law states that a marketing plan relates "to some aspect of the conduct of a party to a contract in conducting business," and gives as examples such things as specification of prices, use of particular sales equipment or specific sales techniques, and cooperation in advertising efforts.<sup>66</sup> Under the Rhode Island law, a marketing plan must concern a "material aspect of conducting business," and it lists several indicia of a marketing plan, including price specifications, sales techniques, training regarding operations or management of the business, and technical or financial guidelines.<sup>67</sup> Washington's law provides that a marketing plan "means a plan or system concerning an aspect of conducting business" and provides similar examples as Rhode Island.<sup>68</sup> We note that Rhode Island's definition is more restrictive, in that it requires that the plan relate to a "material aspect" of the business, while the other two states simply refer to "some aspect" or "an aspect" of the business.

While California does not have a statutory definition of what constitutes a "marketing plan," the California Commissioner of Corporations (now the Commissioner of Business Oversight) has issued a number of interpretive opinions concerning the meaning of the provisions of the California Franchise Investment Law, including the "marketing plan" element of a franchise. Most of those opinions were issued between 1971 and 1975, but a few were issued as recently as the early 2000s.<sup>69</sup> On June 22, 1994, the Commissioner of Corporations promulgated Re-

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<sup>64</sup> Bus. Franchise Guide [CCH] ¶ 8731 (Wis. Comm. Sec. 1986).

<sup>65</sup> Bus. Franchise Guide [CCH] ¶ 9267; *on rehearing* Bus. Franchise Guide [CCH] ¶ 9268 (Vir. State Corp. Comm. 1988) (the rehearing found that a letter from Commission staff that staff was discontinuing an investigation into whether an earlier form of agreement constituted a "franchise" requiring registration under Virginia law was not binding on the Commission as a determination that the current agreement was not a franchise).

<sup>66</sup> Ill. Comp. Stat. § 705/3(18).

<sup>67</sup> R.I. Gen. Laws § 19-28.1-3 (12).

<sup>68</sup> Rev. Code Wash. § 19.100.010 (11).

<sup>69</sup> Copies of the opinions (without any sort of index) are available at <http://businesslaw.calbar.ca.gov/Publications/OpinionResources/FranchiseOpinions.aspx> (last accessed June 6,

lease No. 3-F<sup>70</sup> under the California Franchise Investment Law, which compiles the results of these opinions as a narrative discussion of “When ... an Agreement Constitute[s] a Franchise.” Release 3-F (quoting from Commissioner’s Opinion 73/39F) indicates that in determining whether a marketing plan exists, the facts must be interpreted in accordance with the objectives of the law, and indicates that an appearance of centralized management will increase the likelihood of a franchise being found to exist. Release 3-F also provides several examples of factors found to constitute marketing plans, including prescribing prices and assigning exclusive territories.

Case law has not narrowed down the standards of what it takes to constitute a marketing plan. One case suggests (not surprisingly) that a comprehensive operations manual constitutes a marketing plan.<sup>71</sup> At almost the opposite extreme, another case says that even though a purported franchisor provided little or no direction on the operation of the business of its distributors, a marketing plan still existed because the “franchise” was for the distribution of sports information by beepers, and the information that was distributed was predetermined by the franchisor; as a consequence, the court found that the marketing plan was “self-executing” and did not need to be provided to the distributors.<sup>72</sup> Where the line is to be drawn between these two extremes is hard to tell.

Despite the imprecision of these tests, there appears to be a high likelihood that many shared services agreements will be found to include a “marketing plan substantially prescribed by” the franchisor. For example, many of the shared services arrangements afford the platform company the ability to control pricing (including Uber, Lyft, and Soothe). However, this is not universally true. For example, Airbnb allows the provider to set its own prices). Many of the shared services arrangements also set other parameters of the interaction between the provider and the customer. For instance, Lyft requires its drivers to greet passengers with a fist bump, and both Uber and Lyft require the drivers to use mapping software to determine the route to use. However, because there is no definitive answer as to how much guidance constitutes a marketing plan “substantially prescribed” by the franchisor, it is also possible that some shared services platform companies will be able to avoid characterization as having prescribed a marketing plan in substantial part.

Similarly, at least some affiliation networks likely satisfy the control test. FTC Informal Staff Advisory Opinion 98-6 (August 1998) addresses whether an advertising and marketing “alliance” called “Technology’s Edge” was a franchise.<sup>73</sup> There, the affiliation network solicited

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2016). The Franchise Law Committee of the Business Law Section of the State Bar of California is working on an index of the opinions, which will be published in the same location.

<sup>70</sup> Available at, <http://www.dbo.ca.gov/Commissioner/Releases/3-F.asp> (last accessed June 6, 2016).

<sup>71</sup> *Aurigemma v. Arco Petroleum Products Co.*, 698 F. Supp. 1035 (D. Conn 1988) (“The manual provides accounting standards and auditing procedures, as well as inventory and merchandising criteria that control minimum levels of inventory, the size and placement of any signs or promotional materials, specifications for ... employee uniforms, and the exterior appearance and internal layout of the store .... In addition, the manual provides for initial training in merchandising concepts and convenience store operations. ... The extensive control thus exercised over plaintiffs’ marketing and merchandising strategy supports a finding that, as a matter of law, the ... agreement operated under a marketing plan or system prescribed by” the franchisor.).

<sup>72</sup> *King Computer, Inc. v. Beeper Plus, Inc.*, Bus. Franchise Guide [CCH] ¶10,182 (S.D.N.Y. 1993).

<sup>73</sup> FTC Informal Staff Advisory Opinion 98-6 (Aug. 1998), available at <http://www.ftc.gov/bcp/franchise/advops/advis98-6.shtml> (last accessed Nov. 25, 2013).



technology integration service providers (businesses that sold, tested, and repaired computer equipment and provided computer training services) to join an “alliance” offering advertising and marketing expertise and the right to use the “Technology’s Edge” trademark in a specific geographic territory in exchange for an initial and continuing monthly fee. To qualify for membership, companies had to possess competency certifications from specific computer software manufacturers and attain minimum sales levels over at least two years in business. The FTC concluded that the Technology’s Edge affiliation program was “clearly covered by the Franchise Rule,” though likely exempt from regulation as a fractional franchise.<sup>74</sup>

### 3. State Law (Community of Interest)

The “community of interest” (or “community interest” in Hawaii) test is used more frequently in franchise relationship laws (Mississippi, Missouri, Nebraska, New Jersey, Rhode Island, and Wisconsin) than in franchise sales laws (Hawaii and Minnesota). Most of the cases on this issue come from only two of those states—Minnesota and New Jersey. Even so, the cases are not always consistent in determining whether a community of interest exists.

#### a. The *Ziegler* Test

In *Ziegler Co. v. Rexnord, Inc.*,<sup>75</sup> the court set forth a 10-factor test to determine whether a community of interest exists, considering such factors as the duration of the relationship, the percentage of time devoted to the relationship, and the financial investment required.<sup>76</sup> But the court in *Beloit Beverage Co. v. Winterbrook Corp.*<sup>77</sup> cautioned that while the 10-factor test from *Ziegler* was a convenient structure, the purpose of the statute was to protect dealers against loss of their economic livelihood, and that no test should be applied mechanically or in a way that frustrated the intent of the statute.

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<sup>74</sup> *Id.*; Section 436.8 of the 2007 Franchise Rule, like its predecessor, exempts “fractional franchises” from regulation, which are defined as franchises that meet the following two criteria based on facts existing when the relationship is created: “(1) The franchisee, any of the franchisee’s current directors or officers, or any current directors or officers of a parent or affiliate, has more than two years of experience in the same type of business; and (2) The parties have a reasonable basis to anticipate that the sales arising from the relationship will not exceed 20% of the franchisee’s total dollar volume in sales during the first year of operation.” 16 C.F.R. § 436.1(g) (2013); see also Leonard D. Vines, Beata Krakus & Karen Satterlee, *Fractional Franchise Exemption Friend or Foe?*, 30 FRANCHISE L. J. 72 (Fall 2010).

<sup>75</sup> 407 N.W.2d 873 (Wis. 1987).

<sup>76</sup> The full ten factors laid out by the *Ziegler* Court are: (1) how long the parties have dealt with each other; (2) the extent and nature of the obligations imposed on the parties in the contract or agreement between them; (3) what percentage of time or revenue the alleged dealer devotes to the alleged grantor’s products or services; (4) what percentage of the gross proceeds or profits of the alleged dealer derives from the alleged grantor’s products or services; (5) the extent and nature of the alleged grantor’s grant of territory to the alleged dealer; (6) the extent and nature of the alleged dealer’s uses of the alleged grantor’s proprietary marks (such as trademarks or logos); (7) the extent and nature of the alleged dealer’s financial investment in inventory, facilities, and good will of the alleged dealership; (8) the personnel which the alleged dealer devotes to the alleged dealership; (9) how much the alleged dealer spends on advertising or promotional expenditures for the alleged grantor’s products or services; and (10) the extent and nature of any supplementary services provided by the alleged dealer to consumers of the alleged grantor’s products or services. 407 N.W.2d 873 (Wis. 1987).

<sup>77</sup> 900 F. Supp. 1097, 1104 (E.D. Wis. 1995).

## **b. Control by Licensor Test**

Other approaches to determine if a community of interest exists are simpler than the 10-factor test from *Ziegler*. For instance, in *Intermark Ltd. v. H.B. Smith Co.*,<sup>78</sup> the court looked at the level of control exercised by the licensor, and found that the licensor only controlled the use of the licensed trademarks by the licensee, including controls required by the Lanham Act on the quality of the items produced. This limited degree of control, according to the court, was not considered sufficient to form the basis for a community of interest.

*Cassidy Podell Lynch, Inc. v. SnyderGeneral Corp.*,<sup>79</sup> also used a simpler test than in *Ziegler*. The court observed that the focus should be on the franchisor's control over the franchisee, the franchisee's economic dependence on the franchisor, the disparity in bargaining power, and the presence of a franchise-specific investment. In that case (which involved an air-conditioning distributor), the court found that the distributor "has not presented any evidence that it made a franchise-specific capital investment of either goods or services."

## **c. Franchisee Investment Test**

Another approach is to consider the amount of the franchise-specific investment. Concerning that test, it is interesting to compare *Instructional Systems, Inc. v. Computer Curriculum Corp.*<sup>80</sup> with *Cooper Distributing v. Amana Refrigeration*.<sup>81</sup> In *Instructional Systems*, the court focused on the more than \$100,000 that the distributor had invested in its supplier's computer hardware and software, which could not be resold after the relationship ended. But in *Cooper Distributing*, the District Court found that a franchise-specific investment need not be financial or tangible, and that years of effort to attain specialized skills or knowledge could suffice (on appeal, the Third Circuit affirmed this part of the ruling, and also held that goodwill built up by the local distributor for the products of the manufacturer would count as this type of franchise-specific investment, stating, "For example, sales manager Nathan explained that it was not possible for Cooper's salespeople, after representing for many years that Amana's products were superior, to claim, after the termination, that another product was even better".<sup>82</sup>

We note, however, that not all courts accept that the level of franchisee investment is or should be the sole test for determining whether there is a community of interest. For example, in *Metro All Snax, Inc. v. All Snax, Inc.*<sup>83</sup> the Federal District Court in Minnesota interpreted *Cooper Distributing*<sup>84</sup> as holding that a franchise-specific investment was sufficient, but not necessary, to find a community of interest. The *Metro All Snax* court opined that the existence of a large investment, without more, would allow a finding that a community of interest existed, but the absence of a large investment should not be determinative that no community of interest exists.

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<sup>78</sup> Bus. Franchise Guide [CCH] ¶ 9660 (W.D. Wash. 1990) (applying a prior version of Washington law).

<sup>79</sup> 944 F.2d 1131 (3d Cir. 1991), applying New Jersey law.

<sup>80</sup> 130 N.J. 324 (1992).

<sup>81</sup> Bus. Franchise Guide [CCH] ¶ 10,094; *aff'd in part and rev'd in part*, 63 F.2d 262, 271 (3d Cir. 1995).

<sup>82</sup> *Cooper Distributing*, *supra* note 81, 63 F.2d at 271.

<sup>83</sup> Bus. Franchise Guide [CCH] ¶ 10,885 (D. Minn. 1996).

<sup>84</sup> *Supra*, note 81.

#### **d. Interdependence Test**

Still another test is to examine the interdependence of the parties. This tends to be measured by one of two tests—either the percentage of the manufacturer’s goods sold by the distributor (97% in the case of *Instructional Systems, supra*) or the extent to which the dealer invested heavily in the relationship and staked its economic health on the continuation of the relationship.<sup>85</sup>

#### **e. Common Income Test**

A final test was employed in *Unlimited Horizon Marketing, Inc. v. Precision Hub, Inc.*<sup>86</sup> and followed in *Metro All Snax, Inc. v. All Snax, Inc.*<sup>87</sup> In those cases, the courts found that a community of interest exists if the putative franchisor and the putative franchisees share in income from a common source, such as the franchisor receiving fees from a manufacturer based on purchases/sales by the franchisee.

### **4. Application of the “Control” Tests to Modern Platforms**

Synthesizing the various formulations of the control tests is not easy, especially when trying to apply them to a variety of different agreements in multiple industries. There are, however, lessons to be learned from these cases.

*First*, at least some shared services agreements will meet virtually any version of the control test, particularly when the provider has invested substantial resources, such as leasing a car for Uber or Lyft, and is dependent upon the platform for their income. Many affiliation programs also likely satisfy the “marketing plan” tests, but are less likely to satisfy the “community of interest” tests due to the loose nature of the affiliation. Finally, the shared services providers that participate only modestly in the platform to generate extra income from an asset they already have—such as occasionally renting a room on weekends via a rental platform—may have difficulty establishing the control element except in those states that apply the “community of interest” test of *Metro All Snax*—which finds a “community of interest” so long as the franchisor receives payments based on the services sold by the “franchisee.”

#### **C. Fee Element**

Under the third element of most franchise laws, an arrangement is not a franchise unless the purported franchisee pays a fee of some sort to the franchisor or an affiliate of the franchisor. Most franchise laws exclude *de minimis* fees—typically those under \$500. As of July 2016 under the FTC Franchise Rule, the threshold is set at \$570. Many – but not all – apply a time element, such as requiring that the payment be made the first six months of the relationship in order to constitute a franchise fee. For example, Illinois Franchise Disclosure Act, which is fairly typical of state franchise laws, provides that the fee element is satisfied if “the person granted the right to engage in such business is required to pay to the franchisor or an affiliate of the

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<sup>85</sup> See *Cajan of Wisconsin, Inc. v. Winston Furniture, Inc.*, 21 F.3d 430 (7th Cir. 1994) citing “the utter absence of any ‘shared goals’ or ‘cooperative, coordinated efforts’ between Winston and Cajan”.

<sup>86</sup> 533 N.W.2d 63 (Minn. App. 1995).

<sup>87</sup> *Supra*, note 83.

franchisor, directly or indirectly, a franchise fee of \$500 or more”<sup>88</sup>, with “franchise fee” defined as “any fee or charge that a franchisee is required to pay directly or indirectly for the right to enter into a business or sell, resell, or distribute goods, services or franchises under an agreement.”<sup>89</sup>

## 1. Direct Fees

Almost all franchise sales laws provide that fees can be either “direct or indirect”, with the exceptions are Oregon, which provides that the franchisee must “give ... a valuable consideration” for the franchise, and South Dakota, which requires that the franchisee must make or commit to make a “required payment”.

The typical “direct fee” paid by franchisees is either an “up-front” payment before the franchisee’s business opens<sup>90</sup> or a continuing periodic payment, such a royalty based on a percentage of sales or a flat monthly amount.

In most of the shared services arrangements, there is no cash paid by the provider to the platform company. The money flows from the customer to platform company to the provider.<sup>91</sup> On the other hand, most of the affiliation network programs reviewed by the authors do involve some level of cash payment by the member to the affiliation network.

## 2. Indirect Payments

The definition of a franchise fee generally is not limited to direct cash payments to the purported franchisor, but also includes “indirect fees.” Various payments such as payments for purchases of manuals,<sup>92</sup> and mandatory advertising fees<sup>93</sup> have been held to constitute indirect franchise fees. But notice that the treatment of particular payments is not always consistent, even by the same court. Compare *Pool Concepts, Inc. v. Watkins, Inc.*,<sup>94</sup> in which a portion of the purchase price of inventory that was deposited automatically into a mandatory co-op advertising account was held to constitute a franchise fee, with *R&A Small Engine, Inc. v. Midwest Stihl, Inc.*,<sup>95</sup> in which dealer’s payments for Yellow Pages advertising, meeting attendance expenses, and advertising co-op contributions were held to be “ordinary business expenses” rather than franchise fees.

Purchases of inventory can also constitute indirect fees. The authors are not aware, however, of any shared services programs or affiliation networks that involve the sale of goods,

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<sup>88</sup> 815 Ill. Cons. Stat. § 705/3(1)(c).

<sup>89</sup> 815 Ill. Cons. Stat. § 705/3(14).

<sup>90</sup> See FTC Franchise Rule, *supra* note 30, § 426.5(e).

<sup>91</sup> See Subsection 3, below, “Does It Matter Who Pays Whom?”.

<sup>92</sup> See *To-Am Equipment Co. v. Mitsubishi Caterpillar Forklift America, Inc.*, 152 F.3d 658 (7th Cir. 1998).

<sup>93</sup> *Bly & Sons, Inc. v. Ethan Allen Interiors, Inc.*, Civil No. 05-668-GPM, 2006 WL 2547202 (S.D. Ill. Sept. 1, 2016).

<sup>94</sup> Bus. Franchise Guide [CCH] ¶ 12,249 (D. Minn. 2002).

<sup>95</sup> Case No. 06-877, 2006 WL 3758292 (D. Minn. Dec. 20, 2016).

so there would not be any required inventory purchases. Even if there is a shared services program or affiliation network that requires purchases of inventory, all of the franchise laws have an exception for purchases of reasonable quantities of goods for resale at a bona fide wholesale price.<sup>96</sup> Therefore, unless the technology platform or affiliate network required purchase of inventory, an indirect fee would only be present if either a price higher than a bona fide wholesale price was charged, or excessive quantities of inventory were required.

One interesting case concerning indirect fees is *Ward's Equipment Inc. v. New Holland North America, Inc.*,<sup>97</sup> which involved claims by the dealer that it had paid for training videos and programs, for the use of cooperative advertising, and for purchase of tools, parts, and other goods and services from the manufacturer; the dealer asserted that these purchases satisfied the “fee” requirement. The challenge for the dealer in that case was that there was also language in the two-page Dealer Agreement that read, “The Dealer has not paid any fee for this agreement.” On appeal from a dismissal of the dealer’s case, the Virginia Supreme Court ruled that the trial court did not have to accept as true the dealer’s assertion that it had made any indirect payments to become a franchisee, in light of the statement that no fee had been paid.

In some instances, purported franchisees have argued that items required to be purchased from the franchisor constitute indirect franchise fees. This is consistent with the instructions to Item 5 of the FDD Disclosure Guidelines, which requires disclosure of all initial fees to be paid by a franchisee, and defines “Initial Fees” as “all fees and payments, or commitments to pay, for services or goods received from the franchisor ... before the franchisee’s business opens.”<sup>98</sup> But the courts have not necessarily seen the requirement of disclosure in Item 5 as proof that a particular payment is a “direct or indirect franchise fee” for purposes of determining that an arrangement is a franchise. For example, in *Thueson v. U-Haul Int’l, Inc.*,<sup>99</sup> a U-Haul dealer alleged that the payments it made to the purported franchisor for use of a computer and telephone line constituted payment of a franchise fee. The court disagreed, finding that those were ordinary business expenses for a business of this type.<sup>100</sup>

In all shared services arrangements whether to drive for Uber or Lyft, to rent a house through Airbnb, to provide massages through Soothe, or any other shared service business, the proposed provider must be in a position to provide the services to be shared. In that regard, a few shared services arrangements, such as Airbnb, for example, are flexible in the assets that must be owned, Airbnb does not require its providers to own any particular type of couch, room, or house to list it for rent. But many shared services arrangements require that the providers own or acquire particular assets in order to participate in the shared service arrangement. For example, according to the website on which potential new drivers apply to Uber,<sup>101</sup> a potential Uber driver must have an automobile with four or more doors, from model year 2000 or later,

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<sup>96</sup> See, e.g., California Franchise Investment Law, Cal. Corp. Code § 31011(a); and FTC Franchise Rule, 16 C.F.R. § 436.1(s).

<sup>97</sup> 493 S.E.2d 516 (Va. 1997).

<sup>98</sup> FTC Franchise Rule, *supra* note 30, § 436.5(e).

<sup>99</sup> 144 Cal. App. 4th 664 (2006).

<sup>100</sup> See also *OT Industries, Inc. v. OT-tehdas Oy Santasalo-Sohlbert AB*, 346 N.W.2d 162 (Minn. App. 1984) (holding that ordinary business expenses are not franchise fees).

<sup>101</sup> <http://get.uber.com/drive/> (last accessed Nov. 13, 2015).

that is not salvaged. If the potential driver does not have a car that meets those standards, the driver can apply to lease a car through Uber starting at \$99 per week with a \$250 deposit (the lease can be cancelled on two weeks' notice, and allows unlimited mileage). In addition to a car meeting these standards, the driver must have a smartphone (iPhone 4S or newer or Android 2013 or newer) that runs the Uber App. If the driver does not have a qualifying phone, the driver can rent one from Uber for \$15 per week, plus a refundable \$200 deposit.

Under the "ordinary business expense" line of cases, these types of requirements, either general or specific, should not constitute fees. That answer should not change under existing "ordinary business expense" precedents if the provider purchases or leases the assets from the platform company.

### **3. Does it Matter Who Pays Whom?**

While all affiliation programs reviewed by the authors involve payment from the affiliate member to the network, with the typical shared services arrangement, the platform company pays the provider. However, just because the provider in a shared services arrangement does not pay cash to the platform company, either at the beginning of the relationship or over time does not mean that there are no costs to become a provider in a shared services arrangement. In almost all of the shared services models, the customer pays the platform company, which deducts its fee, then pays the balance to the provider. Even though there is no cash or other consideration flowing from the provider to the operator of the technological platform, because all of the cash flows from the platform company to the provider, there is consideration to the platform company. As discussed below, some have argued that this type of arrangement constitutes an "indirect fee," which most franchise laws characterize as a franchise fee.

Certainly, from an economic perspective, there is no discernable difference to a service provider such as an Uber driver between the situation in which the service provider collects \$10 from a customer then remits \$2 to the operator of the platform company, as compared to the situation in which the platform company collects \$10 from the customer then remits \$8 to the provider. In both cases, the economic reality is that the provider ends up with \$8 and the platform company ends up with \$2. The key question is whether this economic reality involves a "hidden franchise fee" or an "indirect franchise fee."

It has frequently been argued that when a purported franchisor makes payments to a purported franchisee, that any deductions made from those payments constitute indirect fees. For instance, *Koellen v. Snap-On Tools Corp.*<sup>102</sup> involved an employee who sold computer software to auto repair shops in an exclusive territory, on a commission basis. The sales agent's employer developed a competing program, which it sold through a different channel in the same territory. The sales agent sued, alleging this violated his exclusive territory. In response, the employer sought a declaration that it had the right to terminate the sales agent's employment, and the sales agent asserted that he was in fact a franchisee and was protected from termination by Washington law. To establish that he had paid a "fee" for his "franchise," the sales agent asserted that the company deducted money from his commissions for various costs such as training. The court stated (in *dicta*) that these sorts of deductions would have constituted fees if they had been proven by the sales agent, but found that the only proven deductions from the commissions were for the recovery of advance payments of future commissions, which were deducted when customers who cancelled their purchases before the full commission had been

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<sup>102</sup> Bus. Franchise Guide [CCH] ¶ 11,246 (E.D. Wash. 1998).

earned. The position of the court in the *Koellen* case seems to be in the minority, as most cases (as discussed below) hold that deductions from a payment do not constitute indirect fees.

For example, *Communications Maintenance, Inc. v. Motorola, Inc.*<sup>103</sup> (applying Indiana law) involved sales and installation contracts. Specifically, Motorola sold radio systems, and had a contract with Communications Maintenance to install those radios for the customers. Motorola was paid by the customers for a combined “sales and installation” price, and Motorola then paid Communications Maintenance an amount less than what Motorola charged the customer for the installation. Following termination of the contract, Communications Maintenance sued, claiming that the markup received by Motorola on the costs of the installation constituted a “hidden” or “indirect” franchise fee. The court held that the profit margins realized by Motorola could not properly be characterized as a franchise fee.<sup>104</sup>

Other cases involved Avis Rent-A-Car’s “agency operator” model; for example, *Adees Corp. v. Avis Rent-A-Car Sys., Inc.*<sup>105</sup> In *Adees*, Avis held a concession to operate a rental car business at the Long Beach airport. Avis built out the facility, acquired the cars, and contracted with Adees to run the facility. All funds collected by Adees were held “in trust” for Avis, and promptly deposited to an Avis-controlled bank account. Avis paid 10% of time and mileage collections to Adees, as well as 65% of refueling charges, but deducted \$0.20 per day for each car on the lot that was not rented (Adees had an option to return cars to a central facility, thereby avoiding this charge). The contract allowed Avis to terminate on 30 days’ notice, without cause. Avis did so, specifically informing Adees that Adees was not in default, but that Avis had decided to terminate for its own business reasons. Adees sued, claiming that the contract was actually a franchise. The trademark and control elements were conceded by Avis, and the issue came down to whether the moneys retained by Avis were hidden or indirect “franchise fees.” The court held that the funds retained by Avis were not franchise fees, whether those amounts were calculated as a percentage of the amounts paid by the customers or as a monthly amount unrelated to revenues. For a similar outcome under very similar facts but applying Washington law, see *Jon K. Morrison, Inc. v. Avis Rent-A-Car Sys., Inc.*<sup>106</sup>

Another attempt to characterize as a franchise an arrangement similar to fee structures used by many of the shared services businesses is the case of *Atchley v. Pepperidge Farm, Inc.*<sup>107</sup> In that case, Pepperidge Farm consigned product to a distributor, who stocked the product at retailer facilities (although not expressly addressed in the opinion, it appears that the distributor supplied the delivery vehicle). When the products sold, the retailers paid Pepperidge Farm, which then paid a 20% commission to the distributors (less various deductions). After a bench trial, the Court issued an opinion in which it determined that the structure used by Pepperidge Farm (which included both commissions on sales as well as deductions from those

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<sup>103</sup> 761 F.2d 1202 (7th Cir. 1985).

<sup>104</sup> See, also, *Corporate Resources, Inc. v. Eagle Hardware & Garden, Inc.*, 115 Wash. App. 343 (2003) (similar contract for installation of home-improvement products).

<sup>105</sup> Case No. CV 02-06363 GHK, 2003 US Dist. Lexis 26293, (C.D. Cal. Nov. 9, 2003), *aff’d* 157 Fed. Appx. 2 (9th Cir. 2005).

<sup>106</sup> Bus. Franchise Guide [CCH] ¶ 12,701, Case No. C02-2383P, 2003 WL 23119903 (W.D. Wash. Nov. 20, 2003).

<sup>107</sup> Case No. CV-04-0452-EFS (E.D. Wash., filed Nov. 29, 2004).

commissions) did not constitute a “franchise fee” because the distributors made no “unrecoverable investment” in the business.

In summary, one case suggests (in *dicta*) that deductions from commissions constitute indirect franchise fees, while several cases reject that characterization, and hold that funds must flow from the purported franchisee (in this case, providers) to the purported franchisor (in this case, a technology platform company) in order to find that a fee has been paid.

#### **D. Risks of Non-Compliance with Franchise Sales Laws**

Without making a final determination whether any particular shared services arrangement or affiliation network is a “franchise,” what is the consequence under the franchise sales laws if the business is a franchise?

There is no private right of action under the FTC Franchise Rule,<sup>108</sup> but the FTC can bring an action to enforce the FTC Franchise Rule.<sup>109</sup> The states also have authority to bring administrative enforcement actions (and, although rarely exercised, criminal prosecutions) for violations of the state franchise disclosure laws. Typically, states seeking to enforce their franchise sales laws will start with a cease and desist order (sometimes called a “desist and refrain” order) or an order to show cause directed to the franchisor, seeking to force the franchisor to stop making further sales in the state without registration of the franchise.<sup>110</sup> Often, those cases are resolved through entry of a consent order, sometimes requiring the franchisor to offer rescission or to pay a fine to the state.<sup>111</sup>

In addition, the state franchise sales laws generally provide that private parties can sue for damages, restitution, or both, if a franchise is sold without compliance with the state’s franchise sales law. The challenge for a provider under a shared services arrangement is that the provider may have paid nothing or a nominal fee to become a provider under the shared services agreement. Further, since the provider is trying to generate money from existing assets, the provider has typically not invested in any real estate, equipment, or other assets unique to the business, nor has the provider typically given up another job to become a provider. Under those circumstances, whether the remedy is in damages or restitution, there is likely to be no (or minimal) recovery even if the provider prevails.

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<sup>108</sup> See, e.g., *Dreisbach v. Murphy*, 658 F.2d 720 (9th Cir. 1981) (“The [FTC] Act rests initial remedial power solely in the Federal Trade Commission”); *Alfred Dunhill Limited v. Interstate Cigar Company, Inc.*, 499 F.2d 232 (2d Cir. 1974) (“the provisions of the Federal Trade Commission Act may be enforced only by the Federal Trade Commission”).

<sup>109</sup> See, e.g. *FTC v. Minuteman Press International, Inc.*, 53 F. Supp. 2d 248 (E.D.N.Y. 1998).

<sup>110</sup> Selected recent examples include: *In Re: Bookatailor Franchising, Ltd.*, Cal. Dept. of Bus. Oversight, available at [www.dbo.ca.gov/ENF/pdf/2016/Bookatailor%20Franchising%20Ltd.pdf](http://www.dbo.ca.gov/ENF/pdf/2016/Bookatailor%20Franchising%20Ltd.pdf) (last accessed June 13, 2016); *In Re: Perma Treat, Inc.*, Order No. S-16-1857-SC01 (Wash. Dept. Fin. Inst.), available at [www.dfi.wa.gov/documents/securities-orders/S-16-1857-16-SC01.pdf](http://www.dfi.wa.gov/documents/securities-orders/S-16-1857-16-SC01.pdf) (last accessed June 13, 2016); and *In Re: 360 Painting, Inc.*, Case Number 2015-0477 (Md. Sec. Comm.) [www.oag.state.md.us/Securities/Actions/2016/360\\_OSC\\_mtd\\_022316.pdf](http://www.oag.state.md.us/Securities/Actions/2016/360_OSC_mtd_022316.pdf) (last accessed June 13, 2016).

<sup>111</sup> See, e.g., *In Re: Baby Safe Homes, Inc.* matter no. 39862/DPK (Minn. Comm. Commerce) available at [www.cards.commerce.state.mn.us/CARDS/security/search.do?method=showPoup&documentId={007942CD-A979-4742-BC54-58660DCE4647}&documentTitle=276895&documentType=1](http://www.cards.commerce.state.mn.us/CARDS/security/search.do?method=showPoup&documentId={007942CD-A979-4742-BC54-58660DCE4647}&documentTitle=276895&documentType=1) (last accessed June 13, 2016).



## **E. Structuring to Avoid Franchise Laws**

The definitions of “franchise” under all of the pre-sale disclosure laws are multi-part tests. Removing any one of those elements takes the arrangement outside the scope of the franchise disclosure and relationship laws. Of course, it is important if this strategy is followed to be certain that the removed element does not creep back into the relationship. For instance, if the “fee” element is eliminated, it is possible that required purchases over time can convert a “non-franchise” into a franchise as in the *To-Am* case, where the manuals were purchased by the franchisee over a period of several years, instead of at the inception of the relationship.<sup>112</sup>

Most shared services arrangements likely avoid classification as franchises under state disclosure laws due to the current interpretation of the laws that finds a “direct or indirect fee” to be paid only if the provider pays funds to the platform company, but not if the platform deducts a portion of the amounts paid to the provider. Of course, if courts decide to follow the *dicta* in the *Koellen* case that deductions from payments are indirect fees<sup>113</sup> or similar arguments made by franchisee advocates, that outcome could change very quickly. On the other hand, affiliation networks charging more than \$570 for membership are unlikely to avoid the fee element.

Typically, affiliation networks depend on the absence of the “control” element to avoid characterization as a franchise. Because there are multiple variations of this test and the courts have developed so many characterizations of when the tests have been met, it may simply be a matter of time before one (or more) affiliation networks are found to be franchises. So far, at least, the major affiliation networks seem to have avoided any court or administrative determinations that their businesses are franchises. We contend, however, that the analysis is fact-intensive and will be determined on a case-by-case basis.

The structuring tools available to more traditional relationships are also, of course, available to shared services platforms and affiliation networks to avoid characterization as franchises. Exemptions that are most likely to apply are exemptions for bona fide certification programs,<sup>114</sup> co-ops,<sup>115</sup> and fractional franchises,<sup>116</sup> but others also may apply.<sup>117</sup>

## **IV. APPLICATION OF FRANCHISE RELATIONSHIP LAWS**

### **A. Variations in Definition of “Franchise” from Disclosure Laws**

In the states of Hawaii, Illinois, Maryland, Michigan, Minnesota, Virginia, and Washington, the “franchise relationship” provisions of state law are contained in the same overall statute as the franchise disclosure provisions, and so there is no difference in definition of a “franchise”

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<sup>112</sup> *Supra*, note 62.

<sup>113</sup> *Supra*, note 102.

<sup>114</sup> See Spandorf, Brockett & Buono, *supra* note 12.

<sup>115</sup> See, e.g., Cal. Corp. Code § 31005(c) (exempting nonprofit cooperatives meeting certain requirements from state franchise investment laws).

<sup>116</sup> 16 C.F.R. § 436.8(a)(2).

<sup>117</sup> See also Karen B. Satterlee & Leslie D. Curran, *Exemption-Based Franchising: Are You Playing in a Minefield?*, FRANCHISE L. J., 28 Franchise L. J. 191 (Spring 2009).

for purposes of the two parts of the laws.<sup>118</sup> The states of California, Indiana, North Dakota, Rhode Island, and Wisconsin have separate franchise disclosure laws and franchise relationship laws, but the definition of a “franchise” in each law is substantially similar (and, in the states of California and Indiana there is specific guidance that the definitions are to be construed as consistent with one another).

The remaining states/territories that regulate franchise relationships (Alaska, Arkansas, Connecticut, Delaware, Idaho, Iowa, Louisiana, Mississippi, Missouri, Nebraska, New Jersey, Puerto Rico, and Virgin Islands) do not have franchise disclosure laws. Nonetheless, in most of these jurisdictions, the definition of a “franchise” for purposes of their franchise relationship laws is similar to the definitions used in most of the franchise disclosure laws.

A significant difference between the typical definitions in franchise disclosure laws and the definition found in some franchise relationship laws appear in Alaska, Arkansas, Delaware, Connecticut, Missouri, New Jersey, Puerto Rico, Rhode Island, Virgin Islands, and Wisconsin. Each of those states omits in whole or part the “fee” element of the definition of a franchise, so that an arrangement can be a “franchise” even if no franchise fee is paid.<sup>119</sup> (Mississippi is similar, in that it only requires that the agreement be granted “for consideration,” which can be satisfied without any cash payments.) This has particular significance for arrangements, such as most shared-services models, that avoid the definition of a franchise under the investment laws discussed above on the basis that no fee is paid. For any shared service business that avoids classification as a franchise under the franchise investment laws by avoiding the fee element, there is a substantial risk of classification as a franchise in the jurisdictions that do not require payment of any fee for purposes of the franchise relationship laws.

In jurisdictions such as New Jersey where the grant of a license to use a mark in which there is a community of interest in the marketing of goods or services constitutes a “franchise” act)<sup>120</sup> and Arkansas where a license to use a mark within an exclusive or nonexclusive territory is a franchise),<sup>121</sup> it is likely that most of the shared services programs reviewed by the authors will trigger application of the franchise relationship laws unless an exemption from the reach of the law can be found. In that regard, it is worth noting that many of the franchise relationship laws do not have as many exemptions as franchise sales laws.<sup>122</sup>

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<sup>118</sup> See citations to laws in note 22, *supra*.

<sup>119</sup> AK Stat. § 45.45.790; Ark. Code §§ 4-72-201-10; Conn. Gen. Stat. §§ 42-133(e)-(h); Del. Code Ann. tit. 6 §§ 2551-56; Mo. Rev. Stat. §§ 407.400-10 and § 407.420 (2013); N.J.S.A. §§ 56:10-1-12; Wis. Stat. §§ 135.01-07; 10 L.P.R.A. §§ 278 et seq.; 12A V.I.C. § 130 et seq. Note that many of these statutes contain significant other exceptions that are outside the scope of this paper; for example, Alaska’s statute applies for distributorships, and exempts not only motor vehicle dealerships and alcoholic beverage distributors (which are covered by other statutes) but also manufacturers with “50 or fewer employees,” among other exemptions. AK Stat. § 45.45.770, 790.

<sup>120</sup> N.J. Code § 56-10-1, *et seq.*

<sup>121</sup> Ark. Code §§ 4-72-202(1)(A).

<sup>122</sup> For example, New Jersey excludes only licensed businesses that generate less than \$35,000 in annual sales of the affected good or service or that constitute less than 20% of the licensee’s overall business (N.J. Code § 56-10-4(a)), while Arkansas excludes only door-to-door sales (which are governed by another provision of law) and leased departments (Ark. Code §§ 4-72-202(1)(B)).

## B. Prohibited Actions under Franchise Relationship Laws

The typical franchise relationship law prohibits (a) termination without good cause, notice, and an opportunity to cure; and (b) non-renewal upon expiration (sometimes only if the agreement grants a right of renewal). A handful of franchise relationship laws<sup>123</sup> also prohibit encroachment on a territory that has been assigned to the franchisee. This is more likely to be an issue in affiliate networks than in the shared services programs reviewed by the authors in that most shared services models do not assign any sort of territory to the provider.

Assuming that the shared services or affiliation arrangement qualifies as a franchise in a state with a franchise relationship law, the expulsion—whether complete or partial—of a provider or member from an affiliation network or shared services agreement, without cause and prior to the expiration of the term of the agreement, could subject the provider or affiliation network to significant liability. A failure to renew absent good cause could also be a violation of the franchise relationship law.<sup>124</sup> The amount of that liability will depend on the language of the relationship law and the remedies it provides.

Those remedies include actual damages, lost profits, and repurchase of inventory. Additional remedies may be available under the applicable state's false advertising and unfair competition laws. The shared services platforms that are relying upon the absence of a franchise fee to avoid the application of franchise sales laws are at risk of significant penalties under the "no fee" jurisdictions listed above. For example, Missouri allows franchisees to recover for the cancellation of a franchise agreement without proper notice from the franchisor.<sup>125</sup> Remedies include: (1) equitable relief;<sup>126</sup> (2) compensatory damages;<sup>127</sup> (3) damages resulting from the loss of goodwill;<sup>128</sup> (4) attorneys' fees;<sup>129</sup> and (5) other damages.<sup>130</sup> Additionally, Missouri law provides for criminal liability resulting from the lack of proper notice.<sup>131</sup> Similarly, Puerto Rico has enacted broad dealer/distributorship laws that also govern the non-renewal of franchises.<sup>132</sup> The remedies for not complying with that law include an indemnity action where the amount of indemnification is determined by: (1) the actual amount spent on the franchise;<sup>133</sup> (2) the costs of unsold goods in stock;<sup>134</sup> (3) value of the good will of the business;<sup>135</sup> and (4) the profit from last

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<sup>123</sup> Hawaii, Indiana, Iowa, Minnesota, and Washington.

<sup>124</sup> See, e.g., NTFPA.

<sup>125</sup> Mo. Ann. Stat. § 407.405.

<sup>126</sup> *Id.* at § 407.410(2).

<sup>127</sup> *Id.*

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

<sup>130</sup> *Id.*

<sup>131</sup> *Id.* at §§ 407.410(2) & 407.420.

<sup>132</sup> P.R. Laws Ann. tit. 10 § 278a.

<sup>133</sup> *Id.* at § 278b(a).

<sup>134</sup> *Id.* at (b).

5 years.<sup>136</sup> While it may be difficult to determine the “value of the good will of the business” (especially in what may be a franchised business for purposes of the law),<sup>137</sup> an award of damages equal to the profits of the business for the prior 5 years could be significant.<sup>138</sup>

As a result, while the payment structure of shared services platforms may fall outside of franchise sales laws due to the lack of a fee payment to the platform company, they may face a minefield when it comes to franchise relationship laws. This may be particularly problematic, as many platform companies regularly (and materially) terminate their old contracts and require their providers to agree to new contracts.

As a hypothetical example of what could happen, assume a person in Puerto Rico who already owns her own car, signs up to become a driver for Lyft. Her average income (after paying all expenses) is \$20,000 per year. Over the course of several years, Lyft regularly sends new contracts, which the driver must agree to as a condition to continuing as a driver. After she has been a driver for 7 years, Lyft sends a new form of contract to which she does not agree (for whatever reason). Under the terms of the Puerto Rico dealership law, it appears that the driver would be entitled to an “indemnity” of \$100,000, even though she could sign up to start driving for Uber the next day.

## V. CONCLUSION

There is a very fine line between affiliation networks and shared services platforms and franchises. Affiliation networks generally try to avoid the application of franchise law primarily by staying on the right side of the control test, and imposing minimal obligations upon their members. However, the control test is subjective, and varies based on jurisdiction. It would be relatively easy for even a properly established affiliation network to drift across the line into franchising. Some affiliation networks may be relying upon the exemption for *bona fide* certification programs. However, because certification marks must be granted to anyone who meets the certification criteria, but may not be used by the owner of the mark, few affiliation programs meet this test.

Shared services platforms generally avoid franchise status by relying upon a different element of the test—the fee element—by having the platform company collect funds from the customers and distribute the funds to the providers (after taking a cut), rather than having the providers pay a fee. This creates an immediate risk for such platform companies in jurisdictions that do not include a fee element in their relationship act. There also is a longer-term risk that one or

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<sup>135</sup> *Id.* at (c).

<sup>136</sup> *Id.* at (d).

<sup>137</sup> As a matter of trademark law, goodwill associated with a trademark belongs to the owner of the trademark; most franchise agreements confirm this understanding, but the issue may not be addressed in the typical shared services or affiliation network agreement.

<sup>138</sup> There are two important points to consider. First, a common way to value a business is as a multiple of EBITDA (earnings before interest, taxes, depreciation, and amortization), which is essentially profits; common multiples are 3x to 7x EBITDA, so payment of an amount equal to the last five years’ profits is likely to be an approximation of the value of the business. Second, from an accounting perspective, “goodwill” is the excess of the value of the business over the value of the identifiable assets, so the inclusion of goodwill within the law’s direction for “indemnification” may simply represent a direction that there is to be no deduction from the value of the business based upon a claim that the owner of the mark is entitled to the value of goodwill attributable to the mark.

more jurisdictions will reexamine (either by way of a new court interpretation or a modification of the statute) the definition or application of indirect fees, and conclude that the direction in which the money flows is a distinction without a difference. If that happens, the technique used by the platform companies to avoid application of the franchise laws to shared services arrangements would suddenly come into question.

While these risks are real, both shared services platforms and affiliation networks, so far, have avoided the application of franchise investment laws and can avoid franchise relations law concerns by avoiding states that eliminate the fee element.

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