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Avoiding the Franchise Surprise in IP Licensing Agreements

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Introduction

A feature of intellectual property is the ability to let others use it.[1] This expands the reach of the licensed property, benefits licensees by letting them use the property to enhance their own ventures, and benefits the owner by generating revenue in the form of royalties or other kinds of payments.[2] The mechanism by which a property owner permits use by someone else is a license.[3] Licensing lets others use valuable product and service brands, patented inventions, copyrighted expressions, and confidential know-how comprising trade secrets.

An increasingly widespread form of intellectual property license is the business franchise. Franchises are familiar to businesspeople and consumers; fast-food, hotel, automotive, and other franchises are well-known parts of the American economy. Entrepreneurs who create these franchises either know or quickly learn that they are subject to special legal requirements under a rule of the Federal Trade Commission[4] and the laws of thirteen states requiring franchisors to either register or file their disclosure documents with a specified state agency before offering or selling franchises to prospective franchisees.[5]

Because of the importance and value of letting others use intellectual property, licensing is an important part of the American economy and of many intellectual property (IP) law practices. But many IP practitioners are not aware of the franchise laws. Because the scope of franchise laws is not intuitive, practitioners do not consider them or else assume they apply only to transactions intended to be franchises or involving multiple look-alike locations with periodic royalties to be paid.

Many business transactions, however, that are not traditional franchises involve elements common to franchise operations, thereby subjecting them to the rules and regulations that govern franchises.[6] Transactions that IP lawyers view as simple intellectual property licenses may have all the elements that make their agreements franchises, subjecting them and the relationships they create to regulations that govern business franchises.

Ignorance of franchise laws and their wide scope have unintended risks and consequences for clients and counsel. Ignorance may unwittingly expose clients to risks of violating the law by failing to satisfy statutory registration and disclosure requirements for offering and/or selling a franchise. Ignorance may deprive clients of statutory benefits to which they are entitled as franchisees. Lawyers who overlook franchise laws may be criticized (or worse) by their clients;[7] and a lawyer's failure to advise clients properly regarding the law does not excuse any resulting violation by the client.[8]

To reduce these risks, IP practitioners need to have at least a basic understanding of the nature of a franchise relationship, the elements of a relationship that turn it into a franchise, how and when an IP license may be a franchise, and how a licensing or other transaction can be structured to avoid the broad reach of the franchise laws.

What Is a Franchise?

There is no uniform, nationwide definition of what constitutes a business franchise. Rather, there are multiple

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definitions adopted by the Federal Trade Commission, by various states that regulate offers and sales of franchises, and by states that regulate the ongoing franchisor–franchisee relationship or the termination of that relationship.

Franchises are regulated under both federal and state law. Federal rules governing franchise arrangements have been promulgated by the Federal Trade Commission under authority of the Federal Trade Commission Act.[9] State franchise laws are preempted by the federal rules but only to the extent that state laws are less protective of franchisees than are the federal rules.[10]

The Federal Trade Commission rule defines a franchise as a continuing commercial relationship created by any arrangement in which (1) one party (a franchisee) offers, sells, or distributes goods or services supplied, directly or indirectly, by a franchisor and identified by a trademark or other commercial designation owned by the franchisor; (2) the franchisor exercises significant control or provides significant assistance in the franchisee's method of operation and secures, directly or indirectly, a retail outlet or other site for the sale or distribution of the goods or services; and (3) the franchisee is required as a condition of obtaining or starting the franchise operation to make a payment to the franchisor or an affiliate of the franchisor of $500 or more within six months after starting the franchise operation.[11]

Numerous states have enacted definitions of franchises for purposes of their presale registration and disclosure law, to restrict a franchisor's freedom to terminate a franchise early, or not to renew the franchise at the end of its term. State franchise statutes can generally be divided into two categories. Most states define a franchise as containing a "marketing plan or system" element.[12] Several states define a franchise based on a "community of interest" between the parties to the relationship.[13]

States that use the marketing plan framework define a franchise as a continuing commercial relationship in which (1) the franchisor grants the franchisee the right to engage in a business using a marketing plan or system prescribed in substantial part by the franchisor; (2) the franchisee's business is substantially associated with the franchisor's trademarks, service marks, trade names, or other commercial designation; and (3) the franchisee pays a fee.[14] These elements are often referred to in shorthand as a marketing plan, trademark license, and franchise fee.

States that use the community of interest framework define a franchise as a relationship in which (1) the franchisor and franchisee have a community of interest; (2) the franchisee has the right to use the franchisor's trademarks; and (3) the franchisee pays a fee.[15] Community of interest is generally defined as a continuing financial interest between the franchisor and franchisee in operating the franchised business.[16]

If the relationship between parties satisfies the definition of a franchise, compliance with the state's registration and disclosure requirements is needed.

In the most common form, under any of the definitions, the elements combine into businesses that are familiar to almost everyone in the form of traditional quick service restaurant, gasoline station, hotel, real estate brokerage, and myriad other franchises. The typical franchise features the sale of branded goods or services, like McDonalds hamburgers, Texaco fuel, Century 21 real estate brokerage services or Hilton hotel services, sold at retail locations that are independently owned, but have a common appearance and operating procedures. The operator of each unit pays the franchisor a royalty for the privilege of using the name and business system.

The Definitional Elements of a Franchise Have Wide Scope

The definitional elements of a franchise are often interpreted broadly by courts and agencies that administer the franchise laws. As a result, business transactions that deviate from the traditional lay conception of a franchise may still fall within statutory definitions.

For example, an agreement permitting a licensee to practice a patented invention or use a body of trade secret knowledge can meet the definition of franchise. If the licensor provides the licensee training, operational guidance or recommendations for marketing, the marketing plan element may be satisfied. If the licensor allows the licensee to associate the business with the licensor's trademark, the trademark association element may be satisfied. A transaction of this nature inevitably includes payment to the patent or know-how owner, thus satisfying the franchise fee element.

This discussion is not hypothetical; a number of reported decisions discuss the definitional elements of a franchise.

The Trademark Element. Authorities state that a mere grant of authority to use another's trademark, service mark, trade name, or other commercial designation, whether or not the licensee actually uses the mark, is sufficient to satisfy the trademark requirement. When a licensee sells goods or services bearing marks owned by a licensor or when a licensee's operations are conducted under a name associated with a licensor, the required trademark use can also be present. Any substantial association of a product or operation with another's mark can be sufficient.

The wide scope of the trademark association element is illustrated by the California Court of Appeal decision in *Kim v. Servosnax.*[17] An office building's cafeteria operator was *prohibited* from displaying the licensor's "Servosnax" name to customers. Despite this, the court still found the business was substantially associated with the licensor's trademark as contemplated by California's Franchise Investment Law. This was because the licensor's goodwill and reputation were important to the property owner in deciding to allow the cafeteria to operate on the premises. The licensee was associated with the licensor in the property owner's mind.

More recently, a U.S. district court in Illinois held that merely pleading the bare minimum facts of association of a

business with a licensor's trademark was a sufficient allegation of the trademark element.[18] The plaintiff, Ward Enterprises, which operated a retail business selling audio and video products, received a five-year license from the defendant to sell the Olufsen brand of products. After the defendant terminated the license early, Ward sued, claiming violation of the Washington State franchise law. In rejecting the motion to dismiss the franchise law claim, the court noted that under federal pleading rules, the complaint needed only to state bare minimum facts sufficient to notify the defendant of the claim so it could answer. According to the court, "Plaintiff's allegation that its operation was substantially associated with [Defendant's] trademark, trade name and advertising was sufficient to state a claim under the Washington Franchise Act."[19]

The Marketing Plan Element. A typical franchise arrangement involves a level of control exerted by the franchisor over the franchisee's operating hours and techniques, accounting practices, employment policies, advertising, and business location. However, the marketing plan element may be present if assistance is provided in such areas as business training, management, personnel, or in cases where there are site or warranty requirements, inventory controls, or display requirements. A marketing plan may be deemed to exist merely on the basis of controls designed to protect ownership rights in a trademark or service mark.

The marketing plan element was found to be broad in *Gentis v. Safeguard Business Systems.*[20] Gentis had sales representatives who solicited orders for Gentis's record-keeping systems and office products and provided follow-up service but did not control the terms of sales or close deals. They did not buy and resell goods nor set sale prices; they could not make binding agreements with customers nor did they handle billing or collection. The court found that the sales representatives' role in taking orders amounted to the grant of a right to offer or sell goods under a system, which satisfied this element of a franchise relationship.[21]

The Franchise Fee Element. A franchise fee includes any fee or charge that a franchisee is required to pay for the right to enter into a franchise arrangement. Typical are payments for such items as royalties, rents, advertising, training, promotional materials, supplies, bookkeeping, and other services. Purchases from third parties in which the franchisor or an affiliate of the franchisor receives revenue can also satisfy the fee requirement. However, a franchise fee does not include charges for the purchase of goods at a bona fide wholesale price if no obligation is imposed to purchase a quantity in excess of what a reasonable businessperson would purchase under normal circumstances to start or maintain an inventory. The federal franchise fee requirement is satisfied by a payment or payments from the franchisee to the franchisor, required as a condition of obtaining or commencing the franchise operation, of at least $500 within six months of commencing operation.

The wide scope of the franchise fee element is illustrated by a decision of the Court of Appeals for the Ninth Circuit.[22] The Ninth Circuit said that payments made by a boat dealership to the manufacturer for promotional materials that are a common part of many product distributorships—like promotional films, banners, posters, and brochures—could be franchise fees.

As these cases show, the courts take a broad view of what constitutes each element. At the same time, at least in federal courts, plaintiffs can maintain a claim by pleading only the "bare minimum facts sufficient to notify the defendant of the claim." The result is a broad view of what constitutes a franchise.

Unexpected Franchises

With the broad view of the law applied by courts, it is not difficult to hypothesize parties to a seemingly routine patent, trademark, or copyright license facing the surprise of a cogent assertion that the license includes all the elements of a franchise. As an example, a patent license might include a commitment by the patent owner to provide training in the use of the invention and even ongoing marketing and sales consultation. It would not be unusual for the license to encourage the licensee to make use of a clever name or trademark conceived by the patent owner. If, as is usual, the patent licensee pays a royalty to the owner, then all of the elements of a business franchise are potentially present in the relationship.

This common scenario may well include all the elements of a franchise. The patent license, together with consultation and guidance provided by the owner, may satisfy the marketing plan element. The licensee is permitted to associate the business with the patent owner's trademark. Royalty payments readily satisfy the franchise fee element. The same unexpected results could occur as part of the licensing of a trademark, trade secret, or even a copyright, if accompanied by the use of a brand or trade identity, consultation and guidance to the licensee, and payment of a fee.

A farm equipment manufacturer learned this lesson at a high price. For over twenty years, a dealer sold Mitsubishi forklifts. After Mitsubishi ended the relationship, the dealer claimed it had been a franchise, protected from termination by state law. A jury found that a total of $1,600 paid over the twenty-year relationship for sales and service manuals was a franchise fee. This resulted in a $1.5 million damage award for wrongful termination. An appeals court noted that the specialized meaning given to the word "franchise" could surprise even sophisticated parties, as happened here.[23]

Surprises in this area are neither hypothetical nor rare. In 2003 a Los Angeles jury awarded a plaintiff more than $6 million in a case in which the parties expressly agreed in writing that their arrangement was *not a franchise.*[24] The defense claimed the parties believed they were not and did not intend or want to be a franchise.[25]

Implications of the Accidental IP Franchise

The FTC's disclosure rule and state franchise investment laws were enacted to provide prospective franchisees

with the information needed to make informed decisions concerning an offered franchise and to prohibit sales of franchises that would lead to fraud or a likelihood that a franchisor's promises would not be met.[26] To achieve these goals, the states with franchise registration and disclosure laws prohibit offering or selling a franchise unless the offer is registered with the state or exempted from registration.[27]

If an exemption is not available, an application for registration of an offer must be filed with the state's franchise law administrator. The application includes extensive information concerning the proposed franchise arrangement, the franchisor, persons associated with the franchisor, and financial information.

The application must be accompanied by an offering prospectus that discloses material information to prospective franchisees. When approved by the state, the prospectus, together with copies of all proposed agreements, must be provided to a prospective franchisee and a cooling-off period must elapse before the franchisee can sign any agreement or pay any money relating to the franchise.[28] The length of the state-mandated cooling-off period varies, but because of a preemptive Federal Trade Commission rule, as a practical matter the cooling-off period is ten business days (fourteen calendar days in Illinois).[29] Under the FTC's franchise rule, the offering circular must be presented with all attachments no later than the first in-person meeting to discuss the possible sale of the franchise or ten business days before the franchisee either signs any agreement or pays any amount to purchase the franchise, whichever is earlier.[30]

Unknowingly entering into a franchise arrangement creates unexpected risks and costs. Under the franchise laws of many states any person who offers or sells a franchise in violation of the registration, disclosure, and cooling-off requirements is liable to the franchisee for damages caused,[31] and in cases of willful violation, the franchisee is entitled to rescind the agreement and recover the investment.[32]

Criminal sanctions are also potentially available. Recently, the Justice Department obtained criminal convictions against promoters of a franchise scheme in an action in which the FTC's Franchise Rule Administrator testified as an expert.[33] In a number of states that have franchise registration laws, the failure to comply with the law's requirements is a felony.[34] Some felony prosecutions, in fact, have occurred.[35]

If a continuing business relationship is a franchise in states with franchise relations acts, a franchisor cannot lawfully terminate the relationship except in compliance with the state's statute.[36]

Violating a state's franchise law, even inadvertently, can have other implications. When liability or a problem accrues, clients may claim they were not properly advised by their lawyer.[37] In a future transaction, such as a corporate sale or financing, an ignorant franchisor may not be able to represent, or get a legal opinion, that it is in compliance with all applicable laws. A company that discovers too late that it had inadvertently granted a franchise may not be able to end the relationship or may have to pay an unexpectedly high cost to end the relationship.

How to Avoid Being an Accidental Franchise

Lawyers often represent clients in transactions in which the elements of a franchise may be present. A logical way to avoid application of the franchise laws is to structure the transaction to eliminate one of the elements so that the definition of a franchise is avoided. This means a choice of the following:

- Avoiding a marketing plan. If a transaction involves payment of fees together with the license of a trademark, then make sure it does not involve the right to distribute goods or services under a marketing plan provided by the entity granting the right. The most straightforward way to avoid this element is to offer no assistance, control, or guidance to the other party to the transaction, except the bare minimum inspection rights that may be needed to protect the licensed trademark.
- Avoid the license of a trademark. If a business transaction involves permission to a party to distribute goods and services together with guidance or assistance amounting to a marketing plan, then prohibit the distributor from associating its business with the originator's trademark.
- Avoid a franchise fee. In this regard, in most states and under the FTC rule, the mere payment for goods to be resold from inventory is not a franchise fee. If a transaction involves the licensing of a trademark together with distribution of goods or services, then limit the payment of any fees to only the payment of a bona fide wholesale price for goods to be resold.
- Open only company-owned stores and expand distribution through the use of employees or sales agents. Employer-employee or principal-agent relationships do not normally include elements of a franchise. This is mainly because they do not involve payment of any kind of fee, as the employer or principal typically pays the employee or agent for his or her services.

There are more ways to avoid or reduce the effect of the franchise laws. In a transaction that a practitioner believes should not be subject to the law, it is possible to request an interpretive opinion from the FTC staff,[38] or to request an interpretive opinion from the state agency that administers the franchise law confirming that the law does not apply[39] and a transaction conducted in accordance with that opinion enjoys immunity from liability under the law.[40]

The franchise laws also include exemptions that can be the basis for structuring a transaction to avoid the laws' most onerous provisions. The most common state exemptions are based on:

- The size of the franchisor (large net worth);[41]
- The sophistication (business experience) of the franchisee. Examples include sales of additional franchises to existing franchisees;[42] sales to franchisor insiders, including former or current officers, directors, managing agents, or owners of the franchisor;[43] sales to franchisees with a high net worth;[44] and experienced franchisees;[45]

• Sales by one franchisee to another either without or with franchisor involvement. This exemption applies most often to permit a franchisee to sell its franchise without being required to comply with the franchise registration, disclosure, and cooling-off period procedures;[46] Limited franchise offers (to one or two franchisees);[47] Small initial investment;[48] and

• The offer of a franchise that is merely the addition of a product or service to an existing business, where the parties do not expect that the additional product or service will account for more than 20 percent of the sales of the existing business.[49]

If the practitioner recognizes a transaction potentially containing all the elements that could implicate the franchise laws, alternatives may be considered to modify the structure of the transaction to avoid being a franchise or to comply with conditions for an exemption.

Conclusion

The franchise laws can have a surprisingly broad reach. In transactions that include the grant of a right to distribute products or services with the use of a trademark and guidance or a marketing plan in exchange for any kind of fee, the business lawyer should consider whether franchise laws apply. If so, then franchise law compliance may be needed. As an alternative, it may be possible to structure the transaction to avoid at least one of the elements that make the relationship a franchise or to fit the transaction within the requirements for an exemption.

Endnotes

1. As an example, a current treatise on merchandising and character licensing reports data indicating that in 2001 more than $177 billion of licensed products were sold worldwide at retail. BATTERSBY & GRIMES, THE LAW OF MERCHANDISE AND CHARACTER LICENSING 1-13 (2002). Their treatise discusses various kinds of licensing, including character licensing, and licensing of national brands, designer names, athletic teams, star players, rock stars, colleges, and universities.

2. *See, e.g., id.* at 1-28 ("Merchandising is popular for the simple reason that it works. It sells products. It permits a small manufacturer to compete on equal terms with a large manufacturer.").

3. *See, e.g.,* Bunn-O-Matic Corp. v. Bunn Coffee Service, Inc., 88 F. Supp. 2d 914, 921 (C.D. Ill. 2000) ("a trademark license is a grant of permission to use the grantor's trademark") (citing MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION (4th ed. 1997) §§ 18:42-18:43); United States v. Wells, 176 F. Supp. 630, 634 (S.D. Tex. 1959) ("a copyright license is a grant of the right to make, use, or sell the copyrighted work).

4. 16 C.F.R. §§ 436.1 *et seq.*

5. These states are California (CAL. CORP. CODE § 31110); Hawaii (HAW. REV. STAT. § 482E-3(c)); Illinois (ILL. REV. STAT., ch. 121 ? para. 705/10); Indiana (IND. CODE § 23-2-2.5-9); Maryland (MD. CODE ANN. BUS. REG. §14-214); Minnesota (MINN. STAT. ANN. § 80C.03); New York (N.Y. GEN. BUS. § 683); North Dakota (N.D. CENT. CODE § 51-19-03); Rhode Island (R.I. GEN. LAWS § 19-28.1-5); South Dakota (S.D. CODIFIED LAWS ANN. § 37-5A-6); Virginia (VA. CODE ANN. § 13.1-560); Washington (WASH. REV. CODE § 19.100.020); Wisconsin (WIS. STAT. § 553.21). Additionally, in six states companies that sell franchises in those states must first file a one-page notice informing the state that they will offer and sell a franchise and must comply with the Federal Trade Commission rule mentioned above. FLA. STAT. ch. 559.802; KY. REV. STAT. ANN. §367.807; MICH. COMP. LAWS § 445.1507a; NEB. REV. STAT. § 59-1722; TEX. BUS. & COM. CODE ANN. § 41.004(b)(8)(B); UTAH CODE ANN. § 13-15-4.5.

6. *See, e.g.,* Boat and Motor Mart v. Sea Ray Boats, 825 F.2d 1285 (9th Cir. 1987) (franchise law applied to boat distributorship); Kim v. Servosnax, 10 Cal. App. 4th 1346, (1992) (franchise law applied to cafeteria in office building),

7. *See, e.g.,* Pyramid Controls v. Siemens, 172 F.3d 516 (7th Cir. 1999) (attorney did not recognize agreement included all the elements of a franchise, court suggests client's "best cause of action may have been a claim against" the attorney); Beverly Hills Concepts v. Schatz, et al., 717 A.2d 724 (Conn. 1998) (malpractice claim against attorney who failed to recognize that a transaction may be a franchise).

8. People v. Gonda 138 Cal. App. 3d 774, 779 (1982) ("Appellants' offer of proof included the testimony of a business lawyer consulted by appellants who allegedly informed them that their contract was not a registrable franchise and "they therefore were not breaking any laws." Reliance on advice of counsel provides no defense to the charges here.").

9. 15 U.S.C. §§ 41 *et seq.*

10. FTC's Note 2 following 16 C.F.R. § 436.3.

11. 16 C.F.R. § 436.2(a).

12. California, Illinois, Indiana, Maryland, Michigan, North Dakota, Rhode Island, Virginia, Washington, and Wisconsin, define a franchise using the "Marketing Plan or System" element.

13. Hawaii, Minnesota, and South Dakota define a franchise using the "community of interest" framework.

14. CAL. CORP. CODE § 31105; ILL. REV. STAT., ch. 121 ? para. 705/3; IND. CODE. § 23-2-2.5-1; MD. CODE ANN. BUS. REG. §14-201; MICH. COMP. LAWS § 445.1502(3) ; MINN. STAT. ANN. § 80C.01; N.D. CENT. CODE § 51-19-02(5); VA. CODE ANN. § 13.1-559; and WASH. REV. CODE § 19.100.010(4). New York, although using the "marketing plan or system" element, differs slightly; New York defines a franchise to include (1) either a marketing plan or system, prescribed in substantial part by the franchisor or substantial association with the franchisor's trademarks (but not necessarily both) and (2) the payment of a fee. N.Y. GEN. BUS. § 681(3).

15. HAW. REV. STAT. § 482E-2; MINN. STAT. ANN. § 80C.01; and S.D. CODIFIED LAWS ANN. § 37-5A-1.

16. HAW. REV. STAT. § 482E-2; WASH. REV. CODE § 19.100.010.

17. Kim v. ServoSnax, 10 Cal. App. 4th 1346 (1992).

18. Ward Enterprises, Inc. v. Bang & Olufsen, 2003 WL 22859793 (N.D. Ill. 2003).

19. *Id.* The court also reached the same conclusion with regard to Plaintiff Ward's allegations of the other elements of a franchise. *See also* FED. R. CIV. P. 8.

20. Gentis v. Safeguard Business Systems, 60 Cal. App. 4th 1294 (1998).

21. 60 Cal. App. 4th at 1305.

22. Boat & Motor Mart v. Sea Ray Boats, 825 F.2d 1285 (9th Cir. 1987).

23. To-Am Equipment Co. v. Mitsubishi Forklift, 152 F.3d 658 (1998).

24. The author testified as an expert witness and the jury found that the relationship was a franchise notwithstanding this agreement. LASVN #2 v. Sperry Van Ness Real Estate (L.A. Superior Court Case No. BC 206251).

25. *See also* Cooper Distr. Co. v. Amana Refrigeration, 63 F3d 262 (3d Cir. 1995) (appliance distributors); Petereit v. S.B. Thomas Inc., 63 F3d 1169 (2d Cir. 1995) (bakery goods); American Bus. Interiors. v. Haworth, 798 F2d 1135 (8th Cir. 1986) (furniture); Aristacar Corp. v. NY Atty. Gen., 143 Misc.2d 551 (1989) (radio dispatched car service was a franchisor; drivers were franchisees).

26. *See, e.g.,* CAL. CORP. CODE §. 31001; HAW. REV. STAT. § 482E-1; R.I. GEN. LAWS § 19-28.1-2.

27. *See* CAL. CORP. CODE § 31110; HAW. REV. STAT. § 482E-3(a); ILL. REV. STAT., ch. 121 ? para. 705/5; IND. CODE § 23-2-2.5-9; MD. CODE ANN. BUS. REG. §14-214(a); MINN. STAT. ANN. § 80C.02; N.Y. GEN. BUS. § 683; N.D. CENT. CODE § 51-19-03; R.I. GEN.

LAWS § 19-28.1-5; S.D. CODIFIED LAWS ANN. § 37-5A-6; VA. CODE ANN. § 13.1-560; WASH. REV. CODE § 19.100.020; WIS. STAT. § 553.21. Exemptions often require a franchisor to file an exemption notice and pay a filing fee. *See, e.g.*, CAL. CORP. CODE §§ 31101(d), 31106(b), 31108(f), 31109(e); IND. CODE. §§ 23-2-2.5-8; MD. CODE ANN. BUS. REG. §14-214(d); N.D. CENT. CODE § 51-19-04(e) and 17; R.I. GEN. LAWS §§ 19-28.1-6(a)(4); S.D. CODIFIED LAWS ANN. § 37-5A-12(4); WASH. REV. CODE § 19.100.030.

28. CAL. CORP. CODE § 31119.

29. 16 C.F.R. § 436.2(g). A proposed amendment to this rule, now under consideration by the FTC, would change the cooling off period from 10 business days to 14 days. *See* Notice of Proposed Rulemaking, 64 Fed. Reg. 57,294 (Oct. 22, 1999).

30. 16 C.F.R. § 436.2(g).

31. CAL. CORP. CODE § 31300, 31301 (franchisee may sue for damages; if the violation is willful, the franchisee may rescind); HAW. REV. STAT. § 482E-9 (franchisee may sue for damages or rescission); ILL. REV. STAT., ch. 121 1/2 para. 705/26 (franchisee may sue for damages and rescission under certain circumstances); IND. CODE. § 23-2-2.5-28 (damages); MD. CODE ANN. BUS. REG. §14-227(b) and (c) (suit for damages; court may also order rescission and restitution to the franchisee); MICH. COMP. LAWS § 445.1531 (suit for damages or rescission); MINN. STATS. § 80C.17(damages or rescission); N.Y. GEN. BUS. LAWS § 691 (damages and if violation is willful, rescission); N.D. CENT. CODE § 51-19-12 (damages or rescission); ORE. REV. STAT. § 650.085 (no specific statute, but franchisee may bring an action based on common law claims); R.I. GEN. LAWS § 19-28.1-21 (damages, costs, attorneys and expert fees and rescission); S.D. CODIFIED LAWS ANN. § 37-5A-83 (damages or rescission); VA. CODE ANN. §§ 13.1-565 and 571 (damages and rescission if grant of the franchise was unlawful, franchisee makes the demand within 72 hours after discovery and not more than ninety days after signing the franchise agreement); WASH. REV. CODE § 19.100.190(2) (damages or rescission); WIS. STAT. § 553.51 (damages for fraud and rescission for improper disclosure).

32. CAL. CORP. CODE § 31300; HAW. REV. STAT. § 482E-9; ILL. REV. STAT., ch. 121 ? para. 705/26; MD. CODE ANN. BUS. REG. §14-227(c); MICH. COMP. LAWS § 445.1531; MINN. STAT. § 80C.17; N.Y. GEN. BUS. LAWS § 691; N.D. CENT. CODE § 51-19-12; R.I. GEN. LAWS § 19-28.1-21; S.D. CODIFIED LAWS ANN. § 37-5A-83; VA. CODE ANN. §§ 13.1-565 (rescission if grant of the franchise was unlawful, franchisee makes the demand within 72 hours after discovery and not more than 90 days after signing the franchise agreement); WASH. REV. CODE § 19.100.190(2); WIS. STAT. § 553.51. *See also* Avcar v. Dollar System Rent-a-Car, 890 F.2d 165 (9th Cir. 1989).

33. United States v. Parker, 364 F.3d 934 (8th Cir. 2004).

34. CAL. CORP. CODE §§ 31410, 31411 (criminal penalty of up to $100,000 and/or one year imprisonment for willful violations and fraud); HAW. REV. STAT. §§ 482E-10.6 (criminal penalties including forfeiture, seizure of property, and imprisonment for one year without possibility of parole); ILL. REV. STAT., ch. 121 1/2 para. 705/25 (criminal penalties for class 2 felonies); IND. CODE §§ 23-2-2.5-36 & 37 (class C felony); MD. CODE ANN. BUS. REG. §14-211; MICH. COMP. LAWS § 445.1538 (fine of not more than $10,000 and imprisonment of up to 7 years); MINN. STAT. § 80C.16(3) ($10,000 fine or 5 years' imprisonment) ;N.Y. GEN. BUS. LAWS § 690, 692 (class A misdemeanor punishable by a fine of not more than $1,000, 1 year imprisonment and restitution); N.D. CENT. CODE § 51-19-14 (Class B felony penalties); R.I. GEN. LAWS §§ 19-28.1-20 (as provided by law); S.D. CODIFIED LAWS ANN. §§ 37-5A-76,79, 80 (as appropriate for a Class 4, 5 or 6 felony); VA. CODE ANN. §§ 13.1-569 (criminal penalty as appropriate for a Class 4 felony or misdemeanor as applicable); WASH. REV. CODE §19.100.210(3) (fine of not more than $5,000 and imprisonment of not more than 10 years); WIS. STAT. § 553.52 (criminal penalty of $5,000 and 5 years' imprisonment.

35. *See, e.g*, People v. Gonda, 138 Cal. App. 3d 775 (1982); People v. Kline, 110 Cal. App. 3d 597 (1980).

36. *See, e.g.*, CAL. BUS & PROFS. CODE §§. 20,000 *et seq*; JRS Products, Inc. v. Matsushita Electric Corp., 115 Cal. App. 4th 168 (2004).

37. *See e.g.*, Pyramid Controls v. Siemens 172 F.3d 516 (7th Cir. 1999); Beverly Hills Concepts v. Schatz, 717 A.2d 724 (Conn. 1998).

38. 16 C.F.R. § 1.1-1.4,

39. *See, e.g.*, CAL. CORP. CODE § 31510, ILL. REV. STAT., ch. 121 ? para. 705/32; IND. CODE §§ 23-2-2.5-5; MD. CODE ANN. BUS. REG. §14-209; MINN. STAT. § 80C.18(2); N.D. CENT. CODE § 51-19-16(5); R.I. GEN. LAWS §§ 19-28.1-27(c); S.D. CODIFIED LAWS ANN. § 37-5A-55; WASH. REV. CODE §§19.100.250; WIS. STAT. § 553.75(5).

40. *See, e.g.*, CAL. CORP. CODE § 31511; N.D. CENT. CODE § 51-19-16(6); R.I. GEN. LAWS §§ 19-28.1-27(a).

41. CAL. CORP. CODE § 31101; ILL. ADMIN. CODE. tit. 14 § 200.202(e); IND. CODE § 23-2-2.5-3(a); MD. REGS. § 02.02.08.10(d); N.Y. GEN. BUS. LAWS § 684(2) and (3)(a); N.D. CENT. CODE § 51-19-04(1); R.I. GEN. LAWS § 19.28.1-6(a)(1); S.D. CODIFIED LAWS § 37-5A-12; WASH. REV. CODE 19.100.030(4)(b). California, Illinois, Indiana, and Washington, for example, require a net worth of at least $5 million. In terms of business experience, these states require the franchisor to have had at least twenty-five franchisees who were in business during the last five years. Maryland, North Dakota, Rhode Island and South Dakota require a net worth of $10 million and at least twenty-five franchisees operating in the last five years; South Dakota requires twenty-five franchisees in operation throughout the past twenty-five years. New York requires a net worth of $5 million but no specific experience is necessary. To claim an exemption, franchisors must normally file an exemption notice and comply with other specific state requirements.

42. CAL. CORP. CODE § 31106(a)(3); HAW. REV. STATS. § 482E-4(a)(6); MD. CODE ANN. BUS. REG. §14-214(b)(2); N.Y. GEN. BUS. LAW § 684(3)(d); R.I. GEN. LAWS § 19-28.1-6(e); WASH. REV. CODE § 19.100.030(6); WIS. ADMIN. CODE § 32.05(1)(e).

43. CAL. CORP. CODE § 31106(a)(2); R.I. GEN. LAWS § 19.28.1-6(c); WASH. REV. CODE § 19.100.030(5).

44. CAL. CORP. CODE § 31109; R.I. GEN. LAWS § 19-28.1-6(d); WASH. ADMIN. CODE § 460.80.108(5), (6) and (8).

45. CAL. CORP. CODE § 31106 (franchisees must have had in the last seven years at least two years experience operating and being in charge of the financial aspects of a business offering similar products or services as those to be offered by the franchise).

46. CAL. CORP. CODE § 31102; HAW. REV. STAT. § 482E-4(a)(7); ILL. REV. STAT., ch. 121 ? para. 705/7; IND. CODE. § 23-2-2.5-4; MD. CODE ANN. BUS. REG. §14-214(c); MICH. COMP. LAWS § 445.1506(1)(f); MINN. STAT. ANN. § 80C.03(a); N.Y. GEN. BUS. LAWS § 684(5); N.D. CENT. CODE § 51-19-04(2); R.I. GEN. LAWS § 19-28.1-6(b); S.D. CODIFIED LAWS ANN. § 37-5A-13); WASH. REV. CODE § 19.100.030(1); WIS. STAT. § 553.23.

47. IND. CODE §23-2-2.5-3; MINN. STAT. ANN. § 80C.03(e); N.Y. GEN. BUS. LAWS § 684(3)(c); WASH. REV. CODE § 19.100.030(4)(b)(2).

48. CAL. ADMIN CODE tit. 10 § 310.011 (less than $500 annually); ILL. ADMIN. CODE, Tit. 14 § 200.105 (less than $500 annually); MD. REGS. 02.02.08.10(c) (less than $100 annually); MICH. COMP. LAWS § 445.1506(6)(c) (less than $500 annually); MINN. STATS. § 80C.01(4)(c) (less than $100 annually); WASH. REV. CODE § 19.100.030(4)(b)(3) (less than $500); WIS. ADMIN. CODE § 32.05(1)(b) (less than $1,000 annually).

49. 16 C.F.R. § 436.2(a)(3)(i); CAL. CORP. CODE § 31108; ILL. REV. STAT., ch. 121 1/2 para. 705/3(c); IND. CODE § 23-2-2.5-1(a)(3); MICH. COMP. LAWS § 445.1506(1)(h); MINN. STAT. ANN. § 80C.01(18); VA. CODE ANN. § 13.1-567.