

Franchises: Popular Business Relationships that Could Be Entered Accidentally.

Introduction

Franchises are a popular business model in the United States because they allow someone who wants to own their own business an avenue to get started even if they do not have an idea of what kind of business to start or very much business experience. Franchises exist in almost all industries including fast-food, hotels, retail, personal services, and fitness facilities. Most people recognize McDonalds Corporation, Subway, 7 Eleven as franchises, but Denny's, Merry Maids, and GNC are also franchises. *Entrepreneur Franchise 500 2018*, entrepreneur.com, <https://www.entrepreneur.com/franchise500/2018/1>.

The franchise relationship between a franchisor and a franchisee is regulated by the Federal Franchise Rule (the "Franchise Rule"), which requires franchisors to disclose certain material information to potential franchisees so that they have all necessary information to weigh the risks of their potential investment. Franchise Rule, [ftc.gov](https://www.ftc.gov). To ensure a franchisor's compliance with the Franchise Rule, the Federal Trade Commission is tasked with its enforcement.

In addition to the Franchise Rule, states may implement their own franchise laws. *Id.* This means that it could be complicated for a franchisor to ensure compliance not only with the Franchise Rule, but also possible different laws for each state. Subway, for example, must ensure that its disclosure statements to potential franchisees comply with the laws of all 50 states. Colorado has not enacted any additional franchise requirements beyond the Franchise Rule.

Franchise Defined

Under the Franchise Rule, a franchise exists when there is a continuing commercial relationship where: 1) a franchisee obtains the right to use the franchisor's trademark or other commercial symbol to operate a business or use in the business; 2) a franchisor has significant control over the franchisee's method of operation; and 3) the franchisee is required to make a payment or payments to the franchisor of at least \$500 during the first six months of operation. 16 C.F.R. §§ 436, 437 (2019); see also, [Franchise Rule Compliance Guide](#).

When determining whether the trademark element is met, the FTC defines the term "trademark" broadly and does not only include trademarks, but also includes trade names, service marks, or other advertising or commercial symbols. [Franchise Rule Compliance Guide](#). The franchisor does not need to be the owner of the trademark but must have the right to license the use of the trademark. *Id.* The element is likely met when the business sells goods or performs services that are identified with the trademark, or the business uses the trademark in its name, whether in whole or in part. *Id.*

The element of control is a more fact-specific inquiry that will differ in each franchisor and franchisee relationship. *Id.* The determinative factor for the control element of the Franchise Rule comes down to whether the degree of control or assistance is determined to be “significant.” *Id.* The more a franchisee reasonably relies on the franchisor’s control or assistance the more likely it will be considered “significant.” *Id.*

Lastly, when analyzing whether the last element is met, the term “payment” is read broadly to capture all sources of revenue paid to the franchisor or its affiliate by the franchisee for the rights to associate with the franchisor, market the franchisor’s goods or services, or to begin the operation of the business. *Id.*

The Accidental Franchise

Parties engaging in a business relationship must be careful to understand the Franchise Rule’s definition of a franchise. If the parties’ business relationship falls under the definition of a franchise, a franchise may exist regardless of the parties’ intent, and the business relationship will be subject to the disclosure requirements of the Franchise Rule. 16 C.F.R. §§ 436, 437 (2019). While there are some exceptions to the Franchise Rule’s definition of a franchise that are not discussed in this article, it is important for those looking to engage in a business relationship to understand the definition of a franchise as well as the rules dictating any exclusions from the definition. *Id.*; see also, [Franchise Rule Compliance Guide](#).

Conclusion

Since franchising is a popular business structure across the United States, it is important to understand what types of business relationships can create a franchise under the definition of the Franchise Rule so that the parties entering into a business relationship can ensure compliance.