

Franchising vs. Licensing – the Illegal Franchise Dilemma

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The Franchise vs. License Dilemma

When confronted with [franchising vs. licensing](#), an increasing number of companies are attempting to expand using what is essentially a franchise business model, but calling it a "license." It's a sign of our troubled economic times and the reasoning goes something like this. "If you call it a 'license,' you won't have to prepare a FDD Franchise Disclosure Document with audited financial statements and register with various regulatory agencies. Franchising is expensive; licensing is inexpensive." It sounds good - almost too good to be true. Not surprisingly, it is too good to be true. The list of elements required to fall into the franchise box is very short and the overwhelming majority of license agreements that allow someone to operate a business turn out to be disguised illegal franchises with significant legal ramifications and risk.

Components of The Franchise vs. License Dilemma

If you help someone get into business (allowing them to use your business brand/mark) this transaction will normally be a regulated activity, subject to substantial penalties for noncompliance. If it looks like a duck and walks like a duck, it's a duck. This guiding legal duck principle (and common sense) answers most franchise vs. license questions. *It doesn't matter what terms are used by the parties in contracts or other documents to describe their relationship.* For example, the contract may call the relationship a license, a distributorship, a joint venture, a dealership, independent contractors, consulting, etc., or the parties may form a partnership or a corporation. This is entirely irrelevant in the eyes of governmental regulators and the courts. Their focus is not on semantics, like what the contract is called, but whether a small number of defining elements are present or not.

A 2011-2012 Evolving Case Involving Franchising vs. Licensing

A home improvement company unfortunately sold "license agreements" without complying with franchise registration and disclosure laws.

The Illinois Attorney General brought an action against the company for violating the Illinois Franchise Disclosure and Registration law, resulting in a Final Judgment and Consent Decree.

That same day, on the opposite coast, the California Department of Corporations issued a Desist and Refrain Order based on failure to comply with California's Franchise Investment Law.

In early 2012, a licensee filed suit against the company for violating the Illinois Franchise Disclosure Act, seeking rescission, damages, attorneys' fees and court costs.

What the final financial hit will amount to in cases like this after attorneys' fees, etc. are considered is impossible to estimate, but it could easily be in the millions.

How Companies End Up In A Franchise vs. License Dilemma

In many cases, companies get themselves into this mess by listening to statements found on the Internet that franchising is expensive and licensing inexpensive. Just call the contract a "license" instead of a "franchise," and don't worry about all the legal red tape of franchising. Again, if something sound's too good to be true, it usually is and this should be a big flashing red light. If it was really that easy, everyone would have done it that way. The 3,000-plus companies that are franchising may be a lot of things, but they're not stupid. Many can afford the very best legal talent available. It's not a coincidence they're *all franchising and not licensing*.

Author credentials and background

Kevin B. Murphy, Mr. Franchise, is a [franchise attorney](#) and [franchise expert](#) based in San Francisco with a 30-year practice devoted exclusively to franchise law. Since 1993, Mr. Murphy has also been an Approved MCLE (Minimum Continuing Legal Education) Provider by the State Bar of California, teaching franchise law, franchising vs. licensing (franchise vs. license), and intellectual property courses to California attorneys. In 2002 -2003 he started, operated and sold a very successful franchise. Mr. Franchise holds degrees in business administration and law from the University of San Francisco and an MBA from San Francisco State University. He is the author of over 50 franchise publications, including 4 books on franchising and one book on trade secrets.