Gavel to Gavel: Control Freaks

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By **Rachel Blue**

Sharing a business idea can mean increasing its value for its owner, building the brand and generating revenue in more than one location. Let's say you're doing great in Tulsa with your computer repair business called House Calls. You think the idea would work almost anywhere, and mention it to a buddy at your high school reunion. Turns out he's been laid off and is looking for a business opportunity. How do you handle letting your buddy open another House Calls location in Enid?

You had the good sense to get a federal registration for your service mark, House Calls. The owner of a trademark (or service mark) can license others to use the mark, but federal law requires a trademark owner to exercise control over the licensee's use of the trademark. In short, if you let your buddy open a House Calls location, you have to make sure he does things right. But how far do you go in controlling his location? Not far enough and your buddy is showing up in a van with House Calls and telling clients he fixes only Apple computers, which damages your reputation (and your trademark rights). If you go too far, you could find yourself in an accidental franchise.

Utter the word "franchise" and most people conjure up the golden arches or the green logo that acts like a siren's call to the caffeine-deprived.

Franchises have the following three basic elements:

- A trademark license.
- A "community of interest," marked by significant assistance to, or control over, the grantee's business, like a prescribed marketing plan.
- Payment of a required fee.

If any one of these elements is missing, it's not a franchise. Conversely, if all of these elements are present, it is a franchise, even if the agreement between the parties say it's not. In short, not every trademark license is a franchise, but every franchise has a trademark license at its heart.

The trademark license and fee elements of the franchise relationships are the easiest to determine. Either they're there or they're not. The control element is more difficult. Exercising "significant control" may push you from a simple trademark license to a franchise. Franchises are subject to disclosure requirements, which means you'd need to provide your buddy with a detailed 23-item disclosure document and numerous exhibits, including your audited financial statements. And, although Oklahoma is not one of them, 15 states have special registration requirements for franchise offerings. Failure to comply with the disclosure or registration requirements can subject you to civil and criminal penalties and fines, as well as contract rescission and full restitution of any fees collected. You may decide that forming a franchise and complying with disclosure requirements make sense to your business, but what if you aren't ready for that?

In most states, including Oklahoma, trademark owners who exercise some limited control over a license arrangement can do so without triggering franchise statutes. In our example, imposing a requirement that your buddy perform background screening on the computer techs who are making house calls would likely be seen as a reasonable control in keeping with a simple license. But an agreement that dictated the kind of cars the techs should drive, the uniforms they must wear, an advertising schedule and required vendors would likely be the type of "significant" control that means the license is really a franchise subject to disclosure requirements, whether that's what the parties intended or not.

Determining what "significant" control is will always be a case-by-case analysis, but some general guidelines have emerged from the courts. "Production" controls, which have to do with the quality of the product or the services being offered, are less likely to create an accidental franchise than "marketing" controls, which speaks to the type, frequency, or character of marketing required to be done in a license arrangement. Frequency and proximity matter, as control over daily operations or relationships with vendors, are more likely to push an agreement over the franchise line. Couching controls as "recommendations" isn't as successful as you might think, especially if the licensee's failure to follow the recommendation has some unpleasant consequence (like an increased fee).

Most often, the question of whether something is a franchise or not doesn't arise until the relationship has gone sour. Your buddy either wants to continue using the trademark without any input or hassle from you, or he doesn't want to pay the license fees. A licensee looking for the nearest exit may try using an "illegal franchise" as a get-out-of-jail-free card. Before entering into what you think is just a license agreement, no matter which side you're on, ask an attorney to review it to be sure you're not getting more than you bargained for.

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