

Substantial Association with a Trademark: A Trap for the Unwary

DANIEL J. OATES, SHANNON L. MCCARTHY, AND DOUGLAS C. BERRY

The issue of what constitutes a franchise is a muddled affair because a commonly accepted definition of *franchise* is elusive.¹ As a result, “legislators, regulators, judges, and practitioners alike all suffer from uncertainty about the exact kinds of arrangements intended to be regulated as franchises.”² The uncertainty stems largely from the varied and often haphazard manner in which the twenty-seven U.S. jurisdictions that have enacted laws pertaining to franchising³ adopted their respective franchising regulatory systems.⁴ The result has been a patchwork of regulatory schemes that often contain unique definitions for the word *franchise*.⁵

But in the majority of the U.S. jurisdictions that regulate franchise relationships, in order for an agreement or business relationship to constitute a franchise subject to regulation, it must in some way be “substantially associated” with a trademark.⁶ Although one would expect the adoption of similar statutes requiring “substantial association” with a trademark, there is significant disagreement about what in fact constitutes substantial association.

The first part of this article summarizes the different standards for substantial association that have been applied in the various jurisdictions, as well as the problems arising from those differences. The second part suggests an alternative test for substantial association that would resolve the flaws in the different jurisdictional approaches and improve consistency while remaining true to the existing statutory text.

Current State Laws

Fifteen jurisdictions define *franchise* as an agreement or business relationship that is, in some way, substantially associated with a trademark,⁷ although the actual language employed



Daniel J. Oates



Shannon L. McCarthy



Douglas C. Berry

for this element of the franchise definition falls into three distinctly different categories:

- Jurisdictions in which an agreement constitutes a franchise if the agreement grants the franchisee the right to sell goods or services that are substantially associated with the franchisor’s trademark (product distribution statutes)⁸
- Jurisdictions in which an agreement constitutes a franchise if the agreement allows the franchise business to be substantially associated with the franchisor’s trademark (authorized use statutes)⁹
- Jurisdictions in which an agreement constitutes a franchise if the operation of the franchisee’s business is substantially associated with the franchisor’s trademark (actual use statutes)¹⁰

Facially, the differences in the statutory language appear significant. Read literally, product distribution statutes have the broadest scope since they require only that the parties’ agreement grant the franchisee the right to sell products or services under the franchisor’s trademark. An agreement that expressly prohibits the franchisee from associating its business with the franchisor’s trademark would not necessarily preclude a franchise under a product distribution statute even though that same agreement would not constitute a franchise under the plain language of an authorized use or actual use statute.

Authorized use statutes are the next broadest. They define a franchise as including an agreement that merely “allows” the franchisee’s business to be substantially associated with the franchisor’s trademark. The permissive language of authorized use statutes suggests that actual substantial association with a trademark is unnecessary. Rather, it may be sufficient that the trademark license is broad enough to permit the possibility of the franchisee substantially associating its business with the franchisor’s trademark even if the franchisee elects not to do so. Moreover, an authorized use statute would appear to apply before the franchisee even begins operating the franchise, provided the agreement allows the use of a trademark.

Conversely, actual use statutes are framed in terms of the franchisee’s “operation” of the franchise business, suggesting that an agreement can constitute a franchise only after the franchisee has begun operating its business. Actual use statutes are also narrower in scope as they would appear to require actual substantial association with the franchisor’s trademark.¹¹

Unfortunately, the textual differences among the statute types do not explain why there is such widespread disagreement about the meaning of the phrase *substantially associated*. To the contrary, the actual language of the statutes has rarely

Daniel J. Oates and Shannon L. McCarthy are associates in the Seattle office of Graham & Dunn PC. Douglas C. Berry is a shareholder with the firm.

played a role in determining when an agreement is substantially associated with a franchisor's trademark. As a result, significant confusion exists among commentators, courts, and regulators as to what standard for substantial association applies under the different statutes.¹² The following discussion examines the standards that are applied in those jurisdictions that have addressed the substantial association element of a franchise.¹³

Connecticut and Michigan

Connecticut is undoubtedly the jurisdiction with the most robust case law interpreting the "substantially associated with a trademark element" of a franchise, with at least eighteen written opinions interpreting that phrase as it is used in the Connecticut Franchise Act (CFA), including two by the state's supreme court and three by federal appeals courts.¹⁴ The test that has evolved over time is largely the product of courts' efforts to construct a workable formula that, consistent with the original purpose of the statute, ensures that franchisors are prevented "from taking unfair advantage of the relative economic weakness of . . . franchisee[s]."¹⁵ The result has been a line of decisions employing a fact-intensive analysis of four different factors:

1. The percentage of the franchisee's sales or profits that are attributable to the trademark¹⁶
2. Close association between the franchisor's trademark and the franchisee as demonstrated by the franchisee's use of the trademark¹⁷
3. The degree to which the public associates the trademark with the franchisee's business¹⁸
4. The severity of the financial harm to the franchisee that would result if the franchisor terminated the franchisee's right to use the trademark¹⁹

The four different factors are ultimately interrelated in that they are all indicators, to some extent, of the degree to which the franchisee's business is dependent on the franchisor's trademark.²⁰ As a result, they also provide a framework for quantifying the degree of association between the franchisee's business and the franchisor's trademark, which is a necessary prerequisite to establishing that the operation of the franchisee's business is *substantially* associated with the franchisor's trademark as opposed to merely associated with the franchisor's trademark.

Courts applying the Michigan Franchise Investment Law (MFIL) have adopted a similar approach.²¹ This is somewhat surprising because Michigan has a product distribution statute that defines the substantially associated element of a franchise broadly such that it includes any agreement that merely authorizes a franchisee to sell branded products.²² Prior to 1984, Michigan had regulations similar to those adopted in Maryland and Wisconsin,²³ which strongly suggested that mere use of the franchisor's mark in the franchisee's business or the contribution to advertising costs would be sufficient to establish substantial association.

In both Connecticut and Michigan, the most important factor that tends to show the degree of the franchisee's dependence on the franchisor's trademark, and the one that is generally

dispositive, is the percentage of the franchisee's business that is attributable to the franchisor's trademark.²⁴ Although prior decisions have made clear that a franchisee's business need not be exclusively or completely associated with the franchisor's trademark in order to satisfy the substantial association prong,²⁵ the Seventh Circuit, in a recent decision applying the Connecticut statute, held that, as a matter of law, a plaintiff claiming protection of the CFA must show that more than 50 percent of its business resulted from its relationship with the trademark owner.²⁶

The Seventh Circuit's imposition of a bright-line rule requiring that no less than 50 percent of the franchisee's business be attributable to sales of the franchisor's products or services is a laudable attempt to quantify when a franchisee's use of the franchisor's trademark crosses the boundary from mere association to substantial association. It also continues the trend of recent decisions toward utilizing objectively quantifiable evidence in the substantial association analysis, in contrast with the historical reliance on subjective factors such as the franchisee's close association with the franchisor's trademark and the public's perception of the parties' relationship.²⁷ The courts' greater reliance on objective data recognizes that whether a franchisee's business is "closely" associated with the franchisor's trademark or perceived by the public to be closely associated with the franchisor's trademark is inevitably in the eye of the beholder.²⁸ There is simply no way to measure "closeness" in an objective and consistent manner.²⁹

Nonetheless, the courts' recent reliance on objectively quantifiable financial data suffers from at least two significant flaws. First, courts have failed to reach any consensus on what financial metric is relevant to the substantial association analysis. Without any analysis or discussion, courts have variously examined the franchisee's gross sales,³⁰ gross profits,³¹ net income,³² gross income,³³ purchases of the franchised products as compared with other products,³⁴ or some combination of each.³⁵ Second, courts have failed to consistently identify the relevant period of time that should be considered when determining the percentage of the franchisee's business attributed to the trademark. Franchise relationships are by their nature long-term, and business volumes can change significantly over time.³⁶ Nonetheless, courts have looked at the year preceding the lawsuit,³⁷ the average business volume during the entire agreement,³⁸ every preceding year of the lawsuit individually,³⁹ estimated future sales,⁴⁰ and other seemingly arbitrary time frames.⁴¹ One significant implication of these cases, however, is that a business that is not substantially associated with a licensor's trademark at the outset of the parties' relationship, and therefore not subject to regulation under franchise laws, may eventually become substantially associated as the parties' relationship matures.

Illinois

The Illinois Franchise Disclosure Act of 1987 (IFDA) is an actual use statute requiring that the franchisee's business be substantially associated with the franchisor's trademark.⁴² A regulation issued by the Illinois attorney general (Rule) attempts to clarify this definitional requirement, providing thus:

A franchisee's business is *substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising or other commercial symbol designating the franchisor or its affiliate* within the meaning of Section 3(1)(b) of the Act, if the franchise or other agreement, the nature of the franchise business or other circumstances permit or require the franchisee to identify its business to its customers primarily under such trademark, service mark, trade name, logotype, advertising or other commercial symbol (hereinafter referred to collectively as "franchisor's mark") or to otherwise use the franchisor's mark in a manner likely to convey to the public that it is an outlet of the franchisor. Mere absence in the franchise agreement of permission to use the franchisor's name or mark will not alone negate "substantial association." A contractual prohibition on use of the franchisor's name or mark must be policed and enforced to insure that the name or mark is not being substantially used without the franchisor's knowledge.⁴³

The Rule makes it clear that, under Illinois law, substance is more important than form. Consequently, satisfaction of the substantially associated element does not turn on any express license to use the franchisor's trademark; it is enough that the franchisee has used the franchisor's marks without the franchisor's complaint, whether by informally consenting to the franchisee's use of the marks or by simply failing to police the franchisee's operations. At least one case under the IFDA is consistent with this approach.⁴⁴

Although the Rule acknowledges that a formal trademark license is not necessary, it does recognize that the franchisee's use of the franchisor's mark must in some sense be

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substantial. A mere license to use a mark will not suffice. The substantially associated requirement is satisfied only if the franchisee's business itself is "primarily" identified by the franchisor's mark or (and this may well be the other side of the same coin) its use of the franchisor's mark is so pervasive that it is "likely to convey to the public that it is an outlet of the franchisor."⁴⁵

The Rule, however, leaves unresolved the question of when the franchisee's trademark usage must be evaluated. Thus, it is unclear whether a franchisee's business must be substantially associated with the franchisor's trademark at the outset of the parties' relationship or whether a relationship that does

not constitute a franchise may transform into one through the passage of time. There are no cases under the IFDA providing any guidance on this issue.

Indeed, there have been few Illinois cases addressing whether a franchisor's mark is substantially associated with a franchisee's business; and of the few that do, only three (all by federal courts in Illinois) refer to the Rule.⁴⁶ For example, in *Mechanical Rubber & Supply Co. v. American Saw & Manufacturing Co.*, plaintiff, a saw blade distributor, filed a complaint under the IFDA alleging that the act applied because the distributor was granted the right to market defendant's branded products.⁴⁷ But the distributor's complaint did not allege any use of defendant's trademark in its business.⁴⁸ Citing the Rule, the court held that such an allegation was insufficient to establish that the distributor's business was substantially associated with the manufacturer's trademark.⁴⁹

Conversely, there are three cases decided by Illinois appellate courts that have addressed the substantial association element of a franchise that do not even reference the Rule and are fundamentally irreconcilable with it.⁵⁰ In each of these cases, the court simply reached a conclusion without extensive analysis. But all of these cases suggest that, irrespective of the Rule, a franchisee's business may be substantially associated with a franchisor's trademark where the association is anything but substantial. Indeed, the requisite association may better be described as inconsequential.

The first of these cases, *Brenkman v. Belmont Marketing, Inc.*, involved an agreement granting the right to sell, within a specified territory, memberships to the American Buyers Club, which allowed members to purchase household furnishings, appliances, and other consumer goods at discounted prices.⁵¹ The court held that the substantial association element was satisfied because the franchisee was allowed to sell memberships identified by the American Buyers Club name.⁵² In short, the mere fact that the franchisee was allowed to use the American Buyers Club name to identify the goods (memberships) it sold was sufficient to satisfy the substantially associated requirement.

Similarly, *Salkeld v. VR Business Brokers* involved an agreement authorizing the distributor to sell "Cocktails Naturally" branded cocktail mixes within a specified territory.⁵³ Even though the business did not operate under the Cocktails Naturally name and the sale of Cocktails Naturally mixes represented only a portion of the distributor's business (it also distributed poultry), the court held that the substantially associated element had been satisfied because the parties' agreement granted the franchisee the right to use the Cocktails Naturally trademark.⁵⁴

Finally, relying on *Salkeld*, the appellate court in *Blankenship v. Dialist International Corp.* held that a sales representative of Dialist telephone attachments was a franchisee because he was allowed to use the trade name *Dialist*, and all promotional materials provided to the sales representative indicated that he should rely on the purported good name of Dialist in marketing the product.⁵⁵ "Given the strong association between the Dialist name and the nature of the product to be distributed and the promised benefits to be derived

from being identified with Dialist International.” the court found “that plaintiff’s business was substantially associated with the trade name Dialist such that the second statutory requirement was satisfied.”⁵⁶

Although these cases are now at least twenty years old, they all suggest, contrary to the Rule and the plain language of the IFDA,⁵⁷ that a franchisee can satisfy the substantially associated element of the franchise definition if it can show a right to use a trademark without regard to whether the franchisee’s business is in fact associated with the mark, much less whether the association is substantial.⁵⁸

California

California was the first jurisdiction to enact a statute regulating the offer and sale of franchises when it adopted the California Franchise Investment Law (CFIL) in 1970.⁵⁹ The California legislature did not define the phrase *substantially associated* in the statute and instead left that task to the California Commissioner of Corporations.⁶⁰ Almost immediately following the enactment of the CFIL, the commissioner began crafting a definition by issuing a long series of opinion letters that have formed the basis for the current definition of *substantial association* under California law.⁶¹

Beginning with some of its earliest opinions, the commissioner interpreted the statute broadly in an effort to apply it to as many different business arrangements as possible.⁶² Thus, for example, in a 1971 letter, the commissioner found that a licensed business was substantially associated with the seller’s trademark when the purchaser was authorized to sublicense the seller’s trademark and the purchaser’s business relied on the seller’s trademark.⁶³ The letter is largely silent on the degree of association necessary in order for the association to be “substantial.” Only in the closing sentences of the letter does the commissioner hint that something more than passing association is necessary, noting that in reaching its conclusion that the licensee’s business satisfied the substantial association element of a franchise, it was “significant” that the licensor’s trademark was “brought to the attention of the licensee’s customers to such an extent that they will identify the business of all licensees with the licensor.”⁶⁴ Beyond that vague assessment, the letter does not quantify how much the purchaser’s business relied on or used the seller’s trademark, nor does it provide any details on whether the purchaser may have been a distributor that sold goods under other manufacturers’ trademarks.⁶⁵ The commissioner’s other opinion letters similarly omit any substantive discussion or analysis of the degree of association between the franchisee’s business and the franchisor’s trademark that is necessary to constitute substantial association.⁶⁶ Indeed, it appears that any association with the franchisor’s mark may suffice as long as either the agreement grants the franchisee the right to use the franchisor’s trademark or the franchisee communicates the franchisor’s trademark to its customers, regardless of how small that communication might be.⁶⁷

In 1980, the California legislature passed the California Franchise Relations Act (CFRA), which governs the post-sale relationship between a franchisor and its franchisees.⁶⁸ The CFRA includes a definition of the term *franchise* that is

almost identical to the definition in the CFIL, but it similarly does not define what is meant by the phrase *substantially associated*.⁶⁹ Instead, the legislature adopted the commissioner’s interpretation of the phrase under the CFIL.⁷⁰

There are relatively few cases in California that address what *substantial association* means for purposes of determining if a business arrangement is a franchise under the CFIL or the CFRA.⁷¹ The only case with any real discussion of the substantial association requirement is *Kim v. Servosnax, Inc.*,⁷² which concerns an agreement that does not appear to meet the definition of a franchise. Defendant in the case was a company that contracted with owners or managers of office buildings to construct on-site cafeterias.⁷³ The company

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would then briefly operate those cafeterias until it could sell the business operations to third parties.⁷⁴ The specific claim at issue in that case arose out of defendant’s sale of a cafeteria business operation to plaintiff.⁷⁵ Defendant’s contract with plaintiff expressly prohibited plaintiff from communicating defendant’s name to customers of the cafeteria or associating its business name in any way with defendant’s trademark.⁷⁶ The court held that even though the agreement prohibited plaintiff from communicating defendant’s trademark to her customers, plaintiff’s business was nonetheless substantially associated with defendant’s trademark because the host company with which defendant first contracted was a first-tier “customer” that relied on defendant’s brand when entering into the contract to build out the cafeteria.⁷⁷

The decision is problematic because it does not discuss whether the success or failure of plaintiff’s business depended in any way upon defendant’s trademark (the purpose of the substantial association requirement). By all appearances, the success of plaintiff’s business depended not on defendant’s initial agreement with the employer to build out the cafeteria but on the quality of the food services that plaintiff provided to cafeteria customers.

Other cases applying the California statute offer no further guidance other than holding in a conclusory fashion that the substantial association element is satisfied where the right to use the franchisor’s trademark is communicated in some fashion to the franchisee’s customers.⁷⁸ There has been no substantive analysis of what a franchisee’s business operation should look like in order for it to have a substantial association with the franchisor’s trademark. The word *substantial* implies something more than a de minimis relationship between the franchisee’s business and the franchisor’s trademark, but California’s case law

and regulatory opinions suggest that nothing more is required. For practical purposes, the commissioner's opinions and the limited cases addressing the phrase indicate that *substantially associated* means "associated" and that no particular showing of significance is necessary.

Indiana

Judicial efforts to define *substantial association* under Indiana's statute can only be described as schizophrenic. Although Indiana has an actual use statute, at times courts have interpreted it as though it were an authorized use statute, finding substantial association where the contract merely authorized the franchisee to associate its business with the franchisor's trademark.⁷⁹ Other courts have interpreted it even more broadly, i.e., as if it were a product distribution statute, finding substantial association where the parties' contract merely authorized the franchisee to sell the franchisor's branded products.⁸⁰

In *Wright Moore Corp. v. Ricoh Corp.*, the Seventh Circuit took this broad interpretation to the extreme, holding that the right to distribute branded products was sufficient to establish the substantial association element even though the parties' agreement expressly prohibited the franchisee from associating its business with the franchisor's trademark.⁸¹

Less than one year later, in *Hoosier Penn Oil Co. v. Ashland Oil Co.*, the Seventh Circuit reversed course and held that the mere authorization to distribute branded products did not satisfy the substantial association element.⁸² Instead, the Seventh Circuit relied on a case applying Connecticut law and

associated with a licensor's trademark. They are as follows:

- Whether the identification of the franchisor's business or use of its service mark, trade name, logotype, advertising, or other commercial symbol is used either by the franchisor or the franchisee to enhance the chances of the franchisee's success in the business of dealing in, selling, or promoting the franchisor's product or service; and
- Whether the agreement provides for the franchisee to contribute a portion of its operating revenue to the franchisor for advertising expenses, or representations made by the franchisor or the franchisor's agents or employees otherwise suggest, require, or compel payment by the franchisee for advertising conducted, managed, or prescribed by the franchisor.⁸⁵

There do not appear to be any published cases or agency opinions that shed any light on whether the presence of one factor is alone sufficient to establish a franchise or what, if any, other factors may be considered.⁸⁶

Both Maryland and Wisconsin have actual use statutes, and the factors set forth in their respective regulations are relatively consistent with the language of those statutes because both factors relate to the degree of association between the franchisor's trademark and the franchisee's business. But both factors are potentially overinclusive, to the extent that they can be construed as allowing a finding of substantial association based on mere use of a trademark without any showing of the degree of such use.

Rhode Island and Virginia

There is very little guidance on the proper application of the substantial association element in Rhode Island and Virginia. Anecdotal evidence suggests that "[t]he Virginia and Rhode Island franchise agencies believe that the 'substantially associated' requirement is satisfied whenever consumers notice a manufacturer's trademark affixed to a product; Rhode Island officials candidly admit that the requirement is thus met by almost all distributors."⁸⁷ Such an interpretation would be appropriate for a product distribution statute, but Rhode Island and Virginia have adopted more limited authorized use and actual use statutes.⁸⁸ Nonetheless, other authorities from those jurisdictions also seem to suggest that the substantial association element would be interpreted very broadly.⁸⁹ The cautious practitioner would be wise to disregard the plain language of the statutes and presume that state regulators will find that any product distribution relationship will satisfy the substantial association requirement.

New York and Washington

Similar to the position taken by California regulators, courts interpreting the substantially associated element under the statutes in New York and Washington have held that this element is satisfied where the franchisee places reliance on the use of the franchisor's trademark in the operation of its business.⁹⁰ But unlike in California, the franchisee's operation of its business must in fact be substantially associated with the franchisor's trademark.⁹¹ Consequently, New York and Washington are

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ultimately found no substantial association because less than 10 percent of the franchisee's business came from the sale of products under the franchisor's trademark.⁸³

Based on the case history, what constitutes substantial association in Indiana is anyone's guess. A court may find substantial association where the agreement expressly prohibits the franchisee from using the mark to identify its business if the agreement allows the franchisee to sell the franchisor's branded products. Alternatively, a court may require the franchisee to show that more than 50 percent of its sales are attributable in some fashion to the franchisor's trademark. The latter interpretation is more consistent with the actual language of the Indiana statute⁸⁴ as well as the recent trend in the case law.

Maryland and Wisconsin

Maryland and Wisconsin have promulgated nearly identical regulations listing two nonexclusive factors that must be considered in determining whether a business is substantially

most similar to Connecticut and Michigan and to the cases applying the Illinois regulations defining *substantial association* in that they require some evidentiary showing connecting the operation of the franchisee's business to the franchisor's trademark.

Unlike Connecticut and Michigan, however, New York and Washington courts have yet to adopt a set of factors that can be applied to establish a minimum threshold for substantial association.⁹² The absence of any discussion about the specific factors that should be considered in the substantial association analysis is undoubtedly a result of the relatively few cases in New York and Washington that have applied that element. It is likely that in future cases, where the specific facts of the case make the substantial association element more problematic, New York and Washington courts will apply the factors adopted in Connecticut and Michigan to resolve the dispute.

Proposed Changes to Current Law

The absence of a consensus on the widely adopted and seemingly straightforward phrase *substantially associated* presents a potentially significant obstacle for manufacturers that market their branded products nationally. The simplest solution would be the adoption of a national franchise regulatory regime that preempts contrary state laws or, alternatively, the promulgation of a uniform statute that clearly defines the substantial association element of a franchise. Despite vigorous advocacy, repeated attempts at adopting these solutions have failed.⁹³

The next-best approach would be for courts and regulators to actually look at the language of each jurisdiction's statute and, although this may be controversial, to apply the law as enacted by the jurisdiction's legislature.⁹⁴

For the small minority of jurisdictions with product distribution and authorized use statutes, the analysis is straightforward. Under both of those types of statutes, the substantial association element should be resolved simply by reference to the parties' agreement. If the required authorizations to sell franchisor-trademarked products or services or to use the franchisor's trademark to identify or promote the franchisee's business are present, along with any other required definitional elements, then the arrangement constitutes a franchise.

For the remaining jurisdictions with actual use statutes, the task is significantly more difficult. To maximize the possibility of widespread acceptance, a uniform test for determining whether a business is substantially associated with a franchisor's trademark should ideally satisfy three criteria.⁹⁵ First, the test should consider only objective evidence of association.⁹⁶ Second, the test should further the purpose of the substantial association requirement, i.e., to protect vulnerable franchisees, which are dependent upon the franchisor's trademark in the operation of their businesses, in their dealings with the franchisor.⁹⁷ And finally, the test should preferably be based on an existing standard that has a track record of consistent application in a similar context.

Luckily, a test that satisfies these requirements is already suggested by the Federal Trade Commission's (FTC) fractional

franchise exemption, which exempts agreements from the FTC Franchise Rule if, among other things, "the parties have a reasonable basis, at the time they enter into the agreement, to anticipate that the sales arising from the relationship will not exceed twenty percent of the franchisee's total dollar volume in sales during the first year of operation" (the sales test).⁹⁸ The sales test satisfies all three criteria. It disregards subjective factors and instead focuses on a concrete, readily identifiable financial metric (a reasonable estimate of the dollar volume of gross sales) measured over at a specific period of time (the franchisee's sales during its first year of operation).⁹⁹ It was specifically designed to protect vulnerable franchisees, evolving from the determination that the 20 percent sales threshold was a reasonable estimate of the point at which the franchisee's business becomes dependent upon the franchisor.¹⁰⁰ And it has a long track record of consistent application.¹⁰¹

The sales test, however, is not a perfect solution to the substantial association problem. Because it arises under the FTC Franchise Rule, which regulates presale disclosures, the rule

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only contemplates whether a business is substantially associated with the franchisor's trademark at the inception of the parties' relationship. Thus, the sales test applies well in the context of presale disclosure violations, which necessarily occur prior to the franchisee's commencement of business operations. But most jurisdictions have also adopted franchise relationship laws that regulate the relationship of the parties during the period of operation of the franchise.¹⁰² Strictly applied, the sales test makes little sense in the context of a mature, well-established business relationship.¹⁰³

Instead of simply using a modified version of the sales test that applies equally well to both presale disclosure/registration violations and to post-sale relationship violations, many courts simply perform a case-by-case review of subjective factors to assess the degree of association with the franchisor's trademark.¹⁰⁴ As a result, there is no clear rule that provides any guidance to future prospective franchisors, and no assurances of consistent results.

A better approach would be to abandon subjective factors and instead apply a modified version of the sales test that is flexible enough to be consistently applied at any time during the parties' relationship. The easiest way to accomplish this is to simply change the relevant time period during which the franchisee's association with the franchisor's trademark is

assessed.¹⁰⁵ Rather than assessing the franchisor's reasonable estimate of sales during the franchisee's first year of operation, the relevant time period should be the first year following the action that allegedly gives rise to liability under the franchise act. Thus, in the context of an alleged presale violation, the modified sales test would be the same as the traditional sales test, i.e., the substantial association element of a franchise would not be met where the franchisor could prove that at the time the parties executed the franchise agreement, the franchisor had a reasonable basis for believing that less than 20 percent of the franchisee's gross sales in the first year of business operations would be attributable to the franchisor's mark.¹⁰⁶ Conversely, if the franchisor decided to take some action that violated a state's relationship provision after the franchisee had commenced business operations, the franchisor would have the burden of proving that at the moment it acted, it had a reasonable basis for believing that less than 20 percent of the franchisee's gross sales in the year following the date of the franchisor's action would be attributable

A better approach would be to abandon subjective factors to determine if a substantial association exists and instead apply a modified version of the sales test.

to sales under the franchisor's mark. In either case, the franchisor would bear the burden of proving that at the time it acts, it has a reasonable basis for believing that the franchise laws do not apply.¹⁰⁷

There are a number of policy benefits to adopting the modified sales test. First, it properly balances the burdens between the franchisor and the franchisee. For example, a nonfranchise distributor that learns that its business has become significantly more reliant on a manufacturer's product line (such as where a distributor of multiple product lines from different manufacturers has one or more of its distribution rights terminated) must seasonably notify the manufacturer of its change in circumstances if it subsequently wishes to invoke the protection of franchise laws. If it does not and a dispute arises, the putative franchisor can legitimately claim that it had a reasonable basis for assuming that franchise laws did not apply.¹⁰⁸ On the other hand, the manufacturer, too, must take some responsibility: the idle manufacturer runs the risk of being deemed a franchisor if it does not actively police the use of its marks¹⁰⁹ or take steps to remain abreast of the putative franchisee's financial condition.

Second, the practical result of the balancing of the burdens will be to foster more communication between parties in their business relationship, an undeniably important ingredient in

a franchise system or any other successful business venture.¹¹⁰

Third, the modified sales test preserves the parties' reasonable expectations. Where the parties' agreement did not create a franchise relationship at the time it was originally executed and the parties have taken care to make sure that the agreement does not evolve into a franchise, one should not be arbitrarily imposed upon them. Indeed, a cautious manufacturer could structure its contracts with distributors to ensure that franchise regulations will not apply by including broad termination rights¹¹¹ and by requiring distributors to submit regular reports detailing the proportion of the distributor's business attributable to sales of the manufacturer's products as compared with sales of other brands. Agreements could even contain triggers that require a distributor to notify the manufacturer if its business becomes too dependent on sales of the manufacturer's products.¹¹²

Finally, incorporating the percentage sales concept into the substantial association analysis recognizes that it is necessary to quantify the degree of association to establish that the operation of the franchisee's business is *substantially* associated, as opposed to merely associated, with the franchisor's trademark. This seemingly obvious point has been overlooked or ignored in California and Illinois, where the mere potential for association, rather than actual and significant association, has been deemed sufficient to establish substantial association.¹¹³

Conclusion

Whether a franchise agreement or business is substantially associated with a franchisor's trademark varies dramatically by jurisdiction, and the judicial decisions on that question often have little or no relationship with the plain language of the jurisdiction's franchise statute. This presents a significant problem for businesses seeking to sell or distribute their branded products or services nationally. To remedy this problem, courts and regulators should reexamine the language of their franchise statutes; and jurisdictions that have actual use statutes should consider adopting a modified sales test, which would hold that the substantially associated element of a franchise has not been met if at the time the franchise relationship is analyzed, the franchisor had a reasonable basis to conclude that sales arising from the relationship would not exceed 20 percent of the franchisee's total dollar volume in sales during the next year of operation.

Unfortunately, until the modified sales test or some other method gains widespread and uniform acceptance, businesses seeking to sell or distribute their branded products or services in jurisdictions applying the substantial association element should continue to be wary of the different meaning given to the phrase. Otherwise, they may find themselves subject to onerous franchise regulations that could have been avoided with the exercise of due caution.

Endnotes

1. See, e.g., David Gurnick & Steve Vieux, *Case History of the American Business Franchise*, 24 OKLA. CITY UNIV. L. REV. 37, 49 (1999) ("Because of the variety of contexts in which the term

'franchise' has been used, there still is no complete agreement about its meaning."); Promulgation of Trade Regulation Rule and Statement of Basis and Purpose, 43 Fed. Reg. 59,614, 59,623 (Dec. 21, 1978) (codified at 16 C.F.R. § 436) [hereinafter SBP] ("At the outset, it should be noted that 'there seems to be a lack of complete agreement' on precisely what elements constitute a franchise."). One of the reasons for such widespread disagreement about what constitutes a franchise is because the difference between a well-intentioned but poorly executed legitimate business venture and a scheme to defraud can be difficult to discern. As a result, the task of deciphering which businesses fall on the "fraud" side of franchising can be extremely difficult, leading many jurists to eschew quantitative measures in favor of a more intuitive approach. Rochelle Spandorf, *Structuring Licenses to Avoid the Inadvertent Franchise*, 2:4 LANDSLIDE 35, 36 (2010) ("Most people think they know a franchise when they see one.").

2. Spandorf, *supra* note 1, at 36.

3. Arkansas, California, Connecticut, Delaware, Florida, Hawaii, Idaho, Illinois, Indiana, Iowa, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, New York, North Dakota, Oregon, Puerto Rico, Rhode Island, South Dakota, Virginia, the Virgin Islands, Washington, and Wisconsin, as well as the U.S. Federal Trade Commission (FTC). Idaho's franchise statute is extremely limited and applies only to prohibit franchisors from requiring franchisees to waive application of Idaho law in the franchise agreement. IDAHO CODE ANN. § 29-110. The laws of the remaining jurisdictions that regulate franchising generally fall into two distinct categories: (1) registration and disclosure laws and (2) relationship laws. See Thomas M. Pitegoff, *Franchise Relationship Laws: A Minefield for Franchisors*, 45 BUS. LAW. 289 (1989).

4. The scramble to regulate franchises at the state level was a response to perceived abuses in franchise relationships and mounting frustration over the FTC's slow response to the crisis. Kim A. Lambert & Charles G. Miller, *The Definition of a Franchise: A Survey of Existing State Legislative and Judicial Guidance*, 9 FRANCHISE L.J. 3 (1989); Thomas J. Collin, *State Franchise Laws and the Small Business Franchise Act of 1999: Barriers to Efficient Distribution*, 55 BUS. LAW. 1699, 1700 (2000); Keith Kanouse, *The FTC Franchise Registry: Its Time Has Come*, 29 FRANCHISE L.J. 17 (2009); Gurnick & Vieux, *supra* note 1, at 56-58.

5. Spandorf, *supra* note 1, at 36 ("While federal and state jurisdictions that regulate franchises share common definitional approaches, each jurisdiction has its own definitional subtleties and mix of exclusions and exemptions. What qualifies as a franchise under the federal franchise sales law may not qualify under state law definitions, or vice versa. What is a franchise in one state may not be a franchise in all the regulating states in which the franchisor operates."); H. Brett Lowell & John F. Dienelt, *Drafting Distribution Agreements: The Unwitting Sale of Franchises and Business Opportunities*, 11 DEL. J. CORP. L. 725, 736 (1986) ("As legislatures differ on which relationships to regulate, which key elements define a relationship, and which relationships should be exempt, there is a resultant lack of uniformity among the statutes. It is quite possible to have a relationship subject to the FTC Rule but not to state franchise and business opportunity statutes, covered by one state franchise or business opportunity law but not by others, or exempt from one state law but not from others. The task of determining coverage under the laws is formidable,

owing not only to this statutory maze but also to the large body of regulations, advisory opinions, and informal administrative practices used to interpret these statutory provisions.").

6. CAL. CORP. CODE § 31005(a)(2); CONN. GEN. STAT. § 42-133e(b); 815 ILL. COMP. STAT. § 705/3; IND. CODE § 23-2-2.5.1; IOWA CODE § 523H.1; MD. CODE ANN., BUS. REG. § 14-201(e); MICH. COMP. LAWS § 445.1502(3); N.Y. GEN. BUS. LAW § 681; N.D. CENT. CODE § 2301.002; OR. REV. STAT. § 650.005(4); R.I. GEN. LAWS § 19-28.1-3; VA. CODE ANN. § 13.1-559; V.I. CODE ANN. tit. 12A, § 130; WASH. REV. CODE § 19.100.010(4); WIS. STAT. § 553.03(4)(a). Although beyond the scope of this article, many jurisdictions have adopted industry specific franchising laws (e.g., motor vehicle distributorships, gasoline distributorships, and liquor distributorships) that apply only where the distributor's business is substantially associated with the manufacturer's trademark. ARIZ. REV. STAT. § 28-4301(12) (motor vehicle dealers); ARK. CODE ANN. § 23-112-103 (motor vehicle dealers); CAL. HEALTH & SAFETY CODE § 18003.8 (manufactured home dealers); CAL. VEH. CODE § 331 (motor vehicle dealers); IOWA CODE § 322A.1 (motor vehicle dealers); IOWA CODE § 322D.1 (farm implement, motorcycle, snowmobile, and all-terrain vehicle franchises); IOWA CODE § 323.1 (gasoline dealerships); KAN. STAT. ANN. § 16-121 (motor vehicle dealers); MD. ANN. CODE art. 2B, § 17-101 (beer distributorships); MINN. STAT. § 462A.05 (beer distributorships); NEB. REV. STAT. § 53-103.14 (beer distributorships); NEB. REV. STAT. § 60-1401.39 (motor vehicle distributorships); NEV. REV. STAT. § 482.043 (motor vehicle and watercraft distributorships); N.H. REV. STAT. ANN. § 357-C:1 (motor vehicle distributorships); N.C. GEN. STAT. § 18B-1201 (beer and wine distributorships); N.C. GEN. STAT. § 20-297.1 (motor vehicle distributorships); N.D. CENT. CODE § 5-04-01 (beer distributorships); OR. REV. STAT. § 650.120 (motor vehicle distributorships); TEX. OCC. CODE ANN. § 2301.002 (motor vehicle distributorships); VT. STAT. ANN. tit. 7, § 701 (beer and wine distributorships); VA. CODE ANN. § 29.1-801 (watercraft distributorships); VA. CODE ANN. § 46.2-1500 (motor vehicle distributorships).

7. Substantial association with a trademark is not a prerequisite to establishing the existence of a franchise under New York law; it is only an element of one of two alternative definitions of a franchise. See, e.g., N.Y. GEN. BUS. LAW § 681(3)(b). A contract may also constitute a franchise, even without a trademark license, if the franchisee is granted the right to engage in a business of offering, selling, or distributing goods and services under a marketing plan prescribed in substantial part by the franchisor, and the franchisee is required to pay a franchise fee. *Id.* § 681(3)(a).

8. Michigan and New York.

9. Iowa and Rhode Island.

10. California, Connecticut, Idaho, Illinois, Indiana, Maryland, North Dakota, Oregon, Virginia, the Virgin Islands, Washington, and Wisconsin. Not all of the statutes in these jurisdictions are identical, however. For example, most actual use statutes require that the "operation of the franchisee's business pursuant to a marketing plan prescribed by the franchisor" must be substantially associated with the franchisor's trademark, while some only require that the "operation of the franchise business" must be substantially associated with the franchisor's trademark. Compare CAL. CORP. CODE § 31005(a)(2), with WASH. REV. CODE § 19.100.010(4). Although the textual difference is minor, some prospective franchisees have argued that the distinction is a meaningful one because it suggests

that in some jurisdictions, the franchisor's trademark need only be substantially associated with that portion of the franchisee's business that is operated "pursuant to a marketing plan prescribed by the franchisor" rather than with the franchisee's entire business. See *Hydro Air of Conn., Inc. v. Versa Techs., Inc.*, 599 F. Supp. 1119, 1125 (D. Conn. 1984) (holding that franchisor's mere authorization of franchisee to sell products under franchisor's marks gave rise to a question of fact on the issue of substantial association because the literal text of the statute required only that the business activities relating to the marketing plan, not franchisee's entire business, be substantially associated with the mark). Consider a convenience store owner who enters into an agreement to open a coffee kiosk inside the convenience store. Although the coffee kiosk franchisor's trademark would undoubtedly be substantially associated with the marketing plan or system for the operation of the coffee kiosk, it would likely not be substantially associated with the franchisee's entire business (most of which would be attributable to operation of the convenience store). Despite the practical consequence arising from a literal interpretation of the textual difference, courts have generally rejected this proposed distinction. *Grand Light & Supply Co. v. Honeywell, Inc.*, 771 F.2d 672, 677 (2d Cir. 1985) ("Where such a literal interpretation of the statute's language would lead to absurd results, we may adopt an alternate construction."); *Hoosier Penn Oil Co. v. Ashland Oil Co.*, 934 F.2d 882, 886 (7th Cir. 1991). *But see Hydro Air*, 599 F. Supp. at 1125.

11. Key to this conclusion is the language in actual use statutes stating that an agreement constitutes a franchise if the operation of the franchisee's business "is" substantially associated with the franchisor's mark. See *Guidiville Band of Pomo Indians v. NGV Gaming, Inc.*, 531 F.3d 767, 774-75 (9th Cir. 2008) (noting that the statute's unequivocal present tense use of the word *is* unambiguously provided that the condition at issue must already exist).

12. Compare *Lowell & Dienelt*, *supra* note 5, at 741 (suggesting that to satisfy the substantially associated element of a franchise, "[i]t will generally be necessary for the franchisor's trademark to be used as or as part of the franchisee's business name"), with MICH. COMP. LAWS § 445.1502(3) (providing that an agreement will constitute a franchise if it grants franchisee the right to sell products or services bearing franchisor's trademark). The FTC has only contributed to the confusion because it expressly refused to adopt a substantial association requirement in its original Franchise Rule, opting instead for a requirement that the franchisee's business be merely "identified" with the franchisor's trademark. 16 C.F.R. § 436.2(a)(1) (i)(A) (1979); SBP, *supra* note 1, at 59,700-01. Nonetheless, the comments to the FTC Rule suggested that mere "identification" with a trademark was substantively identical to "substantial association" with a trademark. SBP, *supra* note 1, at 59,700-01 n.31 ("While the phrase 'substantial association' no longer appears in the definition as adopted, the substance of that requirement is contained [in the adopted definition]."). Thereafter, however, the FTC revised the Franchise Rule, which now provides that an agreement constitutes a franchise if the buyer obtains the right to operate a business that is "identified or associated" with the seller's trademark. 16 C.F.R. § 436.1(h). According to the comments to the amended rule, the amended definition was intended to be substantively the same as the original rule. Disclosure Requirements and Prohibitions Concerning Franchising, 72 Fed. Reg. 15,444, 15,453 (Mar. 30, 2007).

And again, as in the original rule, the FTC expressly rejected calls to include a substantial association requirement in the definition of a franchise, but for an entirely different reason. Instead of its original conclusion that mere identification with a trademark is virtually synonymous with substantial association with a trademark, the FTC now takes the position that the phrases are entirely different and should not be confused. FTC BUREAU OF CONSUMER PROT., DISCLOSURE REQUIREMENTS AND PROHIBITIONS CONCERNING FRANCHISING: STAFF REPORT TO THE FEDERAL TRADE COMMISSION AND PROPOSED REVISED TRADE REGULATION RULE 41 (Aug. 2004), available at www.ftc.gov/os/2004/08/0408franchiserulerpt.pdf [hereinafter STAFF REPORT] ("Finally, we note that adopting a 'substantial association' criterion . . . might unnecessarily impose a new burden of proof in Commission law enforcement actions. Not only would the Commission have to show that the franchisor granted a prospective franchisee the right to use its trademark, but that the trademark use was 'substantial.' We believe this construction goes too far."). Also adding to the confusion are authorities from other jurisdictions that have no requirement of association with a trademark at all in their definition of a franchise and instead have an entirely different "community of interest" requirement. HAW. REV. STAT. § 482E-2; MINN. STAT. § 80C.01; MISS. CODE ANN. § 75-24-51; MO. REV. STAT. § 407.400(1); NEB. REV. STAT. § 87-402(1); N.J. STAT. ANN. § 56:10-3(a). Commentators frequently cite authorities applying statutes with the "substantial association" element in the same discussion as cases applying statutes requiring a community of interest. See, e.g., Mark H. Miller, *Unintentional Franchising*, 36 ST. MARY'S L.J. 301, 312-17, nn.52-56 (2005).

13. Idaho, Iowa, North Dakota, Oregon, and the Virgin Islands have no reported case law or regulatory guidance interpreting the substantial association element of a franchise. South Dakota has adopted language similar to that in the FTC Franchise Rule, requiring only that the buyer's business be "identified or associated" with the seller's trademark. S.D. CODIFIED LAWS § 37-5B-1(10). Similar to *substantially associated*, there is a dearth of authority interpreting the phrase *identified or associated*.

14. *Echo, Inc. v. Timberland Machs. & Irrigation, Inc.*, 661 F.3d 959 (7th Cir. 2011); *Garbinski v. Nationwide Mut. Ins. Co.*, 2011 WL 3164057 (D. Conn. July 26, 2011); *Dittman & Greer, Inc. v. Chromalox, Inc.*, 2009 WL 3254481 (D. Conn. Oct. 6, 2009); *Walker Indus. Prods., Inc. v. Intelligent Motion Sys., Inc.*, 2009 WL 3417438 (Conn. Super. Ct. Oct. 1, 2009); *B&E Juices, Inc. v. Energy Brands, Inc.*, 2007 WL 3124903 (D. Conn. Oct. 25, 2007); *Terex Corp. v. Cubex Ltd.*, 2006 WL 3543706 (N.D. Tex. Dec. 7, 2006); *Contractors Home Appliance, Inc. v. Clarke Distrib. Corp.*, 196 F. Supp. 2d 174 (D. Conn. 2002); *Hartford Elec. Supply Corp. v. Allen-Bradley Co.*, 736 A.2d 824 (Conn. 1999); *Rudel Mach. Co. v. Giddings & Lewis, Inc.*, 68 F. Supp. 2d 118 (D. Conn. 1999); *Advanced Mach. Co. v. Trumpf, Inc.*, 1996 WL 457211 (Conn. Super. Ct. July 18, 1996); *Leisure Unlimited, Inc. v. Dep't 56, Inc.*, 1996 WL 684406 (D. Conn. May 3, 1996); *Petereit v. S.B. Thomas, Inc.*, 63 F.3d 1169 (2d Cir. 1995); *Chem-Tek, Inc. v. Gen. Motors Corp.*, 816 F. Supp. 123 (D. Conn. 1993); *Spear-Newman, Inc. v. E.I. DuPont de Nemours & Co.*, 1991 WL 318725 (D. Conn. Dec. 9, 1991); *Sorisio v. Lenox, Inc.*, 701 F. Supp. 950 (D. Conn. 1988) *aff'd*, 863 F.2d 195 (2d Cir. 1998); *Grand Light*, 771 F.2d 672; *Hydro Air*, 599 F. Supp. 1119; *Muha v. United Oil Co.*, 433 A.2d 1009 (1980).

15. *Grand Light*, 771 F.2d at 677.

16. *Muha*, 433 A.2d 1012 (noting, in dicta, that agreement did not require franchisee to sell franchisor's products exclusively); *Grand Light*, 771 F.2d at 677 (holding that operation of distributor's business was not substantially associated with the manufacturer's trademark where only 3 percent of sales were attributable to trademarked products); *Sorisio*, 701 F. Supp. at 961–62 (holding that operation of distributor's business was not substantially associated with the manufacturer's trademark where less than 10 percent of distributor's total product purchases the three years preceding termination were attributable to trademarked products); *Petereit*, 63 F.3d at 1180 n.2 (noting that the fact that franchisee sold only franchisor's products would support a finding of substantial association); *Advanced Mach.*, 1996 WL 457211, at *3 (holding that operation of franchisee's business was not substantially associated with franchisor's trademark where less than 1 percent of gross income was attributable to trademarked products); *Rudel Mach.*, 68 F. Supp. 2d at 126 (holding that operation of franchisee's business was not substantially associated with franchisor's trademark where only 41 percent of annual sales and 40 percent of gross profits, averaged over the term of the entire agreement, were attributable to trademarked products); *Spear-Newman*, 1991 WL 318725, at *10 (holding that operation of franchisee's business was substantially associated with franchisor's trademark where 23 percent of franchisee's sales in the first ten months of 1991 and 27 percent of franchisee's sales in 1990 were attributable to franchisor's trademark); *Hartford Elec. Supply*, 736 A.2d at 839 (holding that operation of franchisee's business was substantially associated with franchisor's trademark where termination of franchise would result in loss of 50 percent of sales as well as the opportunity to distribute other related products); *Contractors Home Appliance*, 196 F. Supp. 2d at 179 (holding that operation of franchisee's business was not substantially associated with franchisor's trademark where sales of trademarked products amounted to only 13.8 percent of franchisee's gross profits in 1999); *Terex*, 2006 WL 3543706, at *8 (holding that operation of franchisee's business was not substantially associated with franchisor's trademark where only 14.68 percent of franchisee's net income was attributable to trademarked product); *B&E Juices*, 2007 WL 3124903, at *16 (holding that operation of franchisee's business was not substantially associated with franchisor's trademark where only 30 percent to 40 percent of business in 2007 was attributable to trademarked products); *Walker Indus. Prods.*, 2009 WL 3417438, at *9–10 (holding that operation of franchisee's business was not substantially associated with franchisor's trademark where only 35 percent of sales in 2007 were attributable to trademarked products); *Ditman & Greer*, 2009 WL 3254481, at *6 (holding that operation of franchisee's business was not substantially associated with franchisor's trademark where only 42 percent of annual sales and 33 percent to 34 percent of gross profits were attributable to trademarked products); *Echo*, 661 F.3d at 966 (holding that operation of franchisee's business was not substantially associated with franchisor's trademark where less than 50 percent of gross profits and sales were attributable to trademarked products during each year of agreement). *But see Hydro Air*, 599 F. Supp. at 1125.

17. Evidence of the franchisee's association with the trademark includes such evidence as (1) franchisee's use of business cards and stationery bearing the franchisor's trademark; (2) franchisee's

distribution of catalogs, flyers, and promotional materials bearing the franchisor's trademark; (3) use of the franchisor's trademark in the signage at the franchisee's business; (4) use of the franchisor's trademark in the name of the franchisee's business; and (5) use of the franchisor's trademark or name when answering the telephone at the franchisee's business. *See Spear-Newman*, 1991 WL 318725, at *10 (noting that franchisee was linked to franchisor's name through advertising, franchisee's business cards advertised its authorization to distribute franchisor's products, the telephone number of franchisee advertised information about franchisor's products, and franchisee's trucks bore franchisor's trademark); *Chem-Tek*, 816 F. Supp. at 129 (noting that franchisee's representatives identified themselves as authorized representatives, sellers, manufacturers, and distributors of franchisor's products, and franchisee used letterhead and business cards with franchisor's trademarks); *Rudel Mach.*, 68 F. Supp. 2d at 127–28 (evidence of distribution of trademarked material affixed with sticker identifying franchisee was insufficient to show substantial association where advertising materials bore the names of many other manufacturers and listed many other products; franchisee affixed sticker to other manufacturers' brochures; there was no customer to whom franchisee promoted only franchisor's products; none of franchisee's employees exclusively promoted franchisor's products; franchisee's stationary, letterhead, business cards, and uniforms did not reference the trademark; there was no sign at franchisee's office referencing franchisor's name; franchisee's employees did not use franchisor's name when answering calls; and in most states in which franchisee operated, it did not represent franchisor); *Hartford Elec. Supply*, 736 A.2d at 839 (evidence showing that franchisee distributed franchisor's flyers, catalogs, and promotional materials and prominently displayed a sign containing franchisor's name on franchisee's premises supported finding of substantial association with trademark); *Contractors Home Appliance*, 196 F. Supp. 2d at 179 (holding that no substantial association was shown where the only use of trademark was in window stickers and on company sign, appearing alongside brand names and trade dress of other manufacturers); *Garbinski*, 2011 WL 3164057, at *11 (holding that complaint had stated a plausible claim for relief under the CFA where it alleged that plaintiff was obligated by the terms of the parties' agreement to use defendant's trademark extensively on products sold by plaintiff).

18. *Hartford Elec. Supply*, 736 A.2d at 839 (evidence that franchisee was a widely recognized distributor of franchisor's products for fifty years supported finding of substantial association); *B&E Juices*, 2007 WL 3124903, at *16 (holding that operation of franchisee's business was not substantially associated with franchisor's trademark where the marketplace associated the distributor primarily with other manufacturers' products); *Contractors Home Appliance*, 196 F. Supp. 2d at 180 (holding no substantial association where plaintiff "presented no evidence to show that its customers considered business with [plaintiff] as business with [defendant]"). *But see Rudel Mach.*, 68 F. Supp. 2d at 128 ("[T]he duration of a commercial relationship does not appear to be a significant factor in the substantial association inquiry.").

19. *Chem-Tek*, 816 F. Supp. at 129 (noting that franchisee was entitled to show that the abrupt termination had a disastrous effect on its business); *Rudel Mach.*, 68 F. Supp. 2d at 127 (evidence did not show that termination was financially disastrous when franchisee was

still in business four years after termination); *Hartford Elec. Supply*, 736 A.2d at 839–40 (holding that operation of franchisee’s business was substantially associated with franchisor’s trademark where trial court found that termination of franchise would cause franchisee’s business to fail); *B&E Juices*, 2007 WL 3124903, at *16 (holding that operation of franchisee’s business was not substantially associated with franchisor’s trademark where termination of franchise would not cause franchisee’s business to fail); *Dittman & Greer*, 2009 WL 3254481, at *6 (“D&G’s ability to sustain its business without Chromalox shows that this case falls short of [substantial association].”).

20. See *Hartford Elec. Supply*, 736 A.2d 839; *Grand Light*, 771 F.2d at 677 (“Where the franchisee is completely dependent on the public’s confidence in the franchised product for most or all of his business, abrupt severance of the franchise tie, without good cause and without sufficient notice, could spell ruination.”); *Chem-Tek*, 816 F. Supp. at 129 (“The franchisee must be sufficiently dependent on the franchisor that termination would be not only harmful, but disastrous.”).

21. See, e.g., *Jerome-Duncan, Inc. v. Auto-By-Tel, LLC*, 176 F.3d 904, 911–12 (6th Cir. 1999) (holding that operation of franchisee’s business was not substantially associated with franchisor’s trademark where only 4 percent of franchisee’s sales were attributable to sales under distribution agreement); *James v. Whirlpool Corp.*, 806 F. Supp. 835 (E.D. Mo. 1992) (applying the MFIL).

22. MICH. COMP. LAWS § 445.1502(3).

23. Kenneth H. Slade, *Applicability of Franchise and Business Opportunity Laws to Distribution and Licensing Agreements*, 15 AIPLA Q.J. 1, 6 n.11 (1987) (noting that although Michigan had regulations similar to those adopted in Maryland and Wisconsin, those regulations expired when administration of the MFIL passed to the state attorney general on June 19, 1984).

24. *Walker Indus. Prods., Inc. v. Intelligent Motion Sys., Inc.*, 2009 WL 3417438, at 9–10 (Conn. Super. Ct. Oct. 1, 2009) (holding that operation of plaintiff’s business was not substantially associated with defendant’s trademark despite the fact that plaintiff distributed defendant’s catalogs, promotional materials, and flyers; displayed defendant’s trademark on its Web page; and was recognized as a leading distributor of defendant’s products because only 35 percent of sales in 2007 were attributable to trademarked products); *Dittman & Greer*, 2009 WL 3254481, at *6 (holding that operation of plaintiff’s business was not substantially associated with defendant’s trademark despite the fact that plaintiff distributed defendant’s catalogs and promotional materials, plaintiff’s employees carried business cards with defendant’s name and logo, plaintiff displayed defendant’s trademark on its webpage, and plaintiff was recognized as a leading distributor of defendant’s products because only 42 percent of total sales were attributable to trademarked products); *Echo, Inc. v. Timberland Machs. & Irrigation, Inc.*, 661 F.3d 959, 966 (7th Cir. 2011) (“No court . . . has relied solely on the fact that a company went out of business to conclude that a franchise relationship existed.”). Some courts have suggested, however, that a plaintiff could show substantial association without evidence establishing that more than 50 percent of its business comes from sales of the trademarked product or service if the plaintiff “employs such extensive use of the manufacturer’s name and logo that it appears to be its franchisee.” *Dittman & Greer*, 2009 WL 3254481, at *5 (citing *Carlos v. Philips Bus. Sys., Inc.*, 556 F. Supp. 769, 776 (E.D.N.Y. 1983)).

One court has even held that a distributor that received more than 50 percent of its income from sales of a manufacturer’s products did not meet the substantial association element because it sold products of other manufacturers and had its own independent identity separate from the various distributor lines that it carried. *James*, 806 F. Supp. at 842. Although not dispositive, the court in *James* also noted that the fact that the parties’ agreement did not contain the word *franchise* was relevant to the court’s consideration of the substantial association element. *Id.*; see also *Jerome-Duncan, Inc. v. Auto-By-Tel, LLC*, 989 F. Supp. 838, 842 (E.D. Mich. 1997) (“First, the word ‘franchise’ does not appear anywhere in the parties’ agreement. While not dispositive, it is clearly probative of what type of agreement was reached.”); *Sorisio v. Lenox, Inc.*, 701 F. Supp. 950, 960 (D. Conn. 1988). Other jurisdictions, such as New York, have rejected franchisors’ assertions that there is relevance to the phraseology used by the parties because doing so would elevate form over substance. *Aristacar Corp. v. Att’y Gen. of N.Y.*, 541 N.Y.S.2d 165 (N.Y. 1989) (“Avoiding the impact of the New York franchise law by the use of terms other than franchise, et al. would make the law a nullity.”).

25. *Hartford Elec. Supply*, 736 A.2d at 837 (“The statute does not require exclusivity or complete association.”). Indeed, exclusivity would be contrary to the plain meaning of the word *substantially*. *Id.* at 359 (citing BLACK’S LAW DICTIONARY (6th ed. 1990)).

26. *Echo*, 661 F.3d at 966 (“As demonstrated above, TMI failed to show that more than 50% of its business resulted from its relationship with Echo, and thus failed to establish the requisite franchise relationship.”).

27. See cases cited *supra* notes 17–18.

28. Indeed, whether a franchisee’s business is “closely” associated with the franchisor’s trademark or perceived by the public to be associated with the franchisor’s trademark borders on speculation and supplants an objective, reasoned determination about the degree of association between a franchisee’s business and a trademark with the wildly inconsistent “I know it when I see it” standard that is half-jokingly applied by jurists attempting to define *pornography*. *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964) (Stewart, J., concurring) (“I know it when I see it. . .”).

29. Other jurisdictions have taken even more extreme positions, concluding that rather than making a fact-intensive (and admittedly somewhat arbitrary) analysis of the subjective factors that tend to show the degree of association between the franchisee’s business and the franchisor’s trademark, it is simpler to deem a relationship a franchise if the agreement merely allows the franchisee to use the trademark or presents the possibility of substantial association, even if the actual relationship itself cannot support such a finding. See, e.g., *Brenkman v. Belmont Mktg., Inc.*, 410 N.E.2d 500 (Ill. App. Ct. 1980) (holding under Illinois law that the mere fact that franchisee was allowed to use franchisor’s name to identify the goods it sold was sufficient to satisfy the substantially associated requirement); *Cont’l Basketball Ass’n, Inc. v. Ellenstein Enters., Inc.*, 640 N.E.2d 705, 708–09 (Ind. Ct. App. 1994) (holding under Indiana law that the substantial association element was satisfied where the contract allowed franchisee’s business to be substantially associated with franchisor’s trademark even though actual use (or nonuse) of the mark was left entirely to franchisee’s discretion); *Kim v. Servosnax, Inc.*, 10 Cal. App. 4th 1346 (1992) (holding under California law that the

substantial association element was satisfied where customers were aware of franchisor's trademark).

30. *Echo*, 661 F.3d at 959; *Dittman & Greer, Inc. v. Chromalox, Inc.*, 2009 WL 3254481 (D. Conn. Oct. 6, 2009); *B&E Juices, Inc. v. Energy Brands, Inc.*, 2007 WL 3124903 (D. Conn. Oct. 25, 2007); *Hartford Elec. Supply Corp. v. Allen-Bradley Co.*, 736 A.2d 824 (Conn. 1999); *Grand Light & Supply Co. v. Honeywell, Inc.*, 771 F.2d 672 (2d Cir. 1985); *Jerome-Duncan, Inc. v. Auto-By-Tel, LLC*, 989 F. Supp. 838, 911–12 (E.D. Mich. 1997).

31. *Echo*, 661 F.3d at 959; *Dittman & Greer*, 2009 WL 3254481; *Contractors Home Appliance, Inc. v. Clarke Distrib. Corp.*, 196 F. Supp. 2d 174 (D. Conn. 2002); *Rudel Mach. Co. v. Giddings & Lewis, Inc.*, 68 F. Supp. 2d 118 (D. Conn. 1999).

32. *Terex Corp. v. Cubex Ltd.*, 2006 WL 3543706 (N.D. Tex. Dec. 7, 2006).

33. *James v. Whirlpool Corp.*, 806 F. Supp. 835 (E.D. Mo. 1992); *Advanced Mach. Co. v. Trumpf, Inc.*, 1996 WL 457211 (Conn. Super. Ct. July 18, 1996).

34. *Sorisio v. Lenox, Inc.*, 701 F. Supp. 950, 961 (D. Conn. 1988).

35. Indeed, courts have not even provided any guidelines regarding when they will consider sales of other products or services in their analysis. This is extremely problematic because it effectively places the franchisee in control over whether the relationship constitutes a franchise. For example, consider a company that distributes products of multiple manufacturers. If that franchisee feared potential termination by a manufacturer that would result in a loss of 30 percent of its product sales, the company could simply transfer the product lines of other manufacturers to a new affiliated business while retaining only the first manufacturer's product line in the original business. That way, it could accurately claim that 100 percent of its sales would be lost upon termination. A crafty distributor could thus ensure application of franchise laws by creating separate affiliated companies for distribution of each different manufacturer's product lines.

36. *See, e.g., Walker Indus. Prods., Inc. v. Intelligent Motion Sys., Inc.*, 2009 WL 3417438, at *2 (Conn. Super. Ct. Oct. 1, 2009) (addressing applicability of the CFA to distribution relationship that saw franchisee experience a sevenfold increase in business under the franchisor's trademarks during the course of a business relationship that lasted more than ten years).

37. *Contractors Home Appliance, Inc. v. Clarke Distrib. Corp.*, 196 F. Supp. 2d 174 (D. Conn. 2002) (the year before entering into the contract at issue in the case, but five years after the parties originally began working together); *Dittman & Greer, Inc. v. Chromalox, Inc.*, 2009 WL 3254481 (D. Conn. Oct. 6, 2009); *B&E Juices, Inc. v. Energy Brands, Inc.*, 2007 WL 3124903 (D. Conn. Oct. 25, 2007); *Terex*, 2006 WL 3543706; *Walker Indus. Prods.*, 2009 WL 3417438.

38. *Rudel Mach. Co. v. Giddings & Lewis, Inc.*, 68 F. Supp. 2d 118 (D. Conn. 1999).

39. *Echo, Inc. v. Timberland Machs. & Irrigation, Inc.*, 661 F.3d 959 (7th Cir. 2011).

40. *Hartford Elec. Supply Corp. v. Allen-Bradley Co.*, 736 A.2d 824 (1999).

41. *Spear-Newman, Inc. v. E.I. DuPont de Nemours & Co.*, 1991 WL 318725 (D. Conn. Dec. 9, 1991) (reviewing, without discussion, only the last twenty-two months of a twenty-year relationship).

42. 815 ILL. COMP. STAT. 705/3(1)(b).

43. ILL. ADMIN. CODE tit. 14, § 200.103 (emphasis in original).

44. *P & W Supply Co., Inc. v. E.I. Dupont de Nemours & Co., Inc.*, 1991 WL 352614 (N.D. Ill. Sept. 17, 1991). In *P & W Supply*, the putative franchisor argued on a motion for summary judgment that the franchisee's business was not substantially associated with its trademark because the agreement at issue prohibited the use of the franchisor's mark without prior permission. The court rejected the argument because the argument assumed that the franchisee in fact did not use the mark and ignored the possibility that the franchisor had expressly or impliedly licensed the use of the mark by allowing the mark to be used by the franchisee. *Id.* at *3. The court also noted that there was a genuine issue of material fact precluding summary judgment where the putative franchisee's evidence showed that 80 percent of its sales were of the manufacturer's products, the franchisee's customers asked for the manufacturer's products by name, and all of the manufacturer's products sold by the putative franchisee were clearly identified by the manufacturer's trademark. *Id.*

45. ILL. ADMIN. CODE tit. 14, § 200.103.

46. *Mech. Rubber & Supply Co. v. Am. Saw & Mfg. Co., Bus. Franchise Guide (CCH) ¶ 10,106* (C.D. Ill. 1990); *BJB Elec., L.P. v. N. Cont'l Enters., Inc., Bus. Franchise Guide (CCH) ¶ 14,317* (N.D. Ill. 2010); *P & W Supply*, 1991 WL 352614.

47. *Bus. Franchise Guide (CCH) ¶ 10,106.*

48. *Id.*

49. *Id.*; *see also BJB Elec., Bus. Franchise Guide (CCH) ¶ 14,317* (holding that an electrical components distributor did not plead the existence of a franchise where it failed to allege facts indicating that it primarily identified its business to its consumers under the manufacturer's name or that it otherwise conveyed to the public that it was an outlet of the manufacturer).

50. *Brenkman v. Belmont Mktg., Inc.*, 410 N.E.2d 500 (1980); *Salkeld v. V.R. Bus. Brokers*, 548 N.E.2d 1151 (Ill. Ct. App. 1989); *Blankenship v. Dialist Int'l Corp.*, 568 N.E.2d 503 (Ill. App. Ct. 1991). *Brenkman* predates the Rule, which was adopted by the Illinois attorney general in 1984. 8 Ill. Reg. 1367 (Jan. 13, 1984). As the Rule is not even referenced in *Salkeld* or *Blankenship*, it appears that those courts may have erroneously relied on the outdated decision in *Brenkman*.

51. *Brenkman*, 410 N.E.2d at 504.

52. *Id.*

53. *Salkeld*, 548 N.E.2d at 1156. *Salkeld* was distinguished in *Fosdick Poultry Processors, Inc. v. Eager*, 555 N.E.2d 62 (Ill. App. Ct. 1990). In *Fosdick*, the putative franchisee distributed Fosdick poultry, and all poultry sold by the distributor contained a required USDA label identifying Fosdick as the source of the poultry. 555 N.E.2d at 64. The court rejected the argument that the mere use of a government required label was sufficient to show a substantial association with a trademark. *Id.* at 64. As the court noted, "[t]o hold otherwise would mean that as a matter of law a trademark or trade name has been established whenever a product is sold which carries upon it the identity of the manufacturer and place of origin as required by governmental standards." *Id.*

54. *Salkeld*, 548 N.E.2d at 1156. The court also noted that the agreement's boilerplate contained an acknowledgement that there were unspecified "benefits" associated with using the Cocktails Naturally trademark. *Id.*

55. 568 N.E.2d 503, 507 (Ill. App. Ct. 1991).

56. *Id.*

57. The approach taken by the courts in *Brenkman, Salkeld*, and *Blankenship* might be appropriate under an authorized use statute but not under the IFDA, which is an actual use statute. See 815 ILL. COMP. STAT. 705/3(1)(b).

58. The Illinois Appellate Court has at least made it clear that a business is not substantially associated with a trademark where there has not been an express or implied license to use a trademark. Thus, for instance, in *Account Services Corp. v. DAKCS Software Services, Inc.*, 399, 567 N.E.2d 381, 385 (Ill. App. Ct. 1990), the court held that the business was not substantially associated with a trademark where it had only been granted an unexercised option to use the alleged franchisor's trademark.

59. Kanouse, *supra* note 4, at 17; Stephen C. Root, *The Meaning of "Franchise" Under the California Franchise Investment Law: A Definition in Search of a Concept*, 30 MCGEORGE L. REV. 1163, 1164 (1999).

60. CAL. CORP. CODE § 31502 ("The commissioner [of corporations] may . . . defin[e] any terms, whether or not used in this law, insofar as the definitions are not inconsistent with the provisions of this law.").

61. See Cal. Dep't of Corps., Comm'r Op. No. 71/6F (Mar. 3, 1971); Cal. Dep't of Corps., Comm'r Op. No. 71/16F (Mar. 18, 1971); Cal. Dep't of Corps., Comm'r Op. No. PL/37F (Aug. 6, 1971); Cal. Dep't of Corps., Comm'r Op. No. 72/27F (Aug. 9, 1972); Cal. Dep't of Corps., Comm'r Op. No. 73/5F (Feb. 2, 1973); Cal. Dep't of Corps., Comm'r Op. No. 73/18F (May 2, 1973); Cal. Dep't of Corps., Comm'r Op. No. 73/20F (May 21, 1973); Cal. Dep't of Corps., Comm'r Op. No. 73/35F (Sept. 19, 1973); Cal. Dep't of Corps., Comm'r Op. No. 74/7F (May 3, 1974); Cal. Dep't of Corps., Comm'r Op. No. 78/1F (May 9, 1978); Cal. Dep't of Corps., Comm'r Op. No. 82/1F (Jan. 11, 1982).

62. See generally Cal. Dep't of Corps., Comm'r Op. No. PL/37F (noting that in reaching its conclusion as to whether the proposed business arrangement constituted a franchise, the commissioner considered the legislature's directive to extend the reach of the statute to the many different types of problematic business relationships).

63. *Id.*

64. *Id.*

65. *Id.*

66. See Cal. Dep't of Corps., Comm'r Op. No. 71/6F (no discussion of substantial association where the agreement granted franchisee the right to use the trademark); Cal. Dep't of Corps., Comm'r Op. No. 72/27F (stating substantial association occurs where franchisor's trademark is communicated to franchisee's customers); Cal. Dep't of Corps., Comm'r Op. No. 73/5F (determined to be a franchise where franchisee would display a small sign with franchisor's name and where franchisee would host an annual miniature golf tournament using franchisor's name).

67. See, e.g., Cal. Dep't of Corps., Comm'r Op. No. PL/37F. California's interpretation of the substantial association element is problematic for two reasons. First, although mere authorization to use a trademark would satisfy the substantial association element under an authorized use statute, California has adopted an actual use statute. Second, by finding substantial association with a trademark when the parties' agreement merely authorizes use of the trademark without requiring a showing that the franchisee has

in fact substantially associated its business with the franchisor's trademark, the word *substantial* is effectively read out of the statute.

68. CAL. BUS. & PROF. CODE §§ 20000–20004.

69. *Id.* § 20001(b).

70. CAL. BUS. & PROF. CODE § 20009 ("The regulations, releases, guidelines and interpretive opinions of the Commissioner of Corporations under the [CFIL] . . . regarding whether or not an agreement constitutes a 'franchise' within the meaning of that law shall be prima facie evidence of the scope and extent of coverage of the definition of 'franchise' under this chapter.").

71. *Kim v. Servosnax, Inc.*, 13 Cal. Rptr. 2d 422 (Ct. App. 1992); *Gabana Gulf Distrib. Ltd. v. Gap Int'l Sales, Inc.*, 2008 WL 111223 (N.D. Cal. Jan. 9, 2008), *aff'd*, 343 F. App'x 258 (9th Cir. 2009); *Roberts v. C.R. England, Inc.*, 848 F. Supp. 2d 1087 (N.D. Cal. 2012).

72. *Kim*, 13 Cal. Rptr. 2d at 422.

73. *Id.* at 423.

74. *Id.*

75. *Id.* at 426.

76. *Id.* at 426–27.

77. *Id.* at 427–28 ("[H]ost companies such as Nicolet are customers of the licensees to whom the name of the franchisor is communicated and thus the licensee's operation of the cafeteria or other food service enterprise is substantially associated with Servo's name.").

78. See *Gabana Gulf Distrib.*, 2008 WL 111223 (holding that the substantial association element was not satisfied even though plaintiff sold Gap-branded apparel in the Middle East because it was prohibited from using the Gap name or trademark in its business dealings with its customers), *aff'd*, 343 F. App'x 258; *Roberts*, 848 F. Supp. 2d 1087 (suggesting that the fact that plaintiffs were required to identify themselves under defendant's name and trademark would satisfy the second prong of substantial association but for the fact that the customers were those of defendants and not plaintiffs); see also Cal. Dep't of Corps., Comm'r Op. No. 3-F: When Does an Agreement Constitute a "Franchise" § 3 (June 22, 1994).

79. *Cont'l Basketball Ass'n, Inc. v. Ellenstein Enters., Inc.*, 640 N.E.2d 705, 708–09 (Ind. Ct. App. 1994) (holding that substantial association element was satisfied where contract allowed franchisee's business to be substantially associated with franchisor's trademark even though "the extent to which [the franchisee] actually used the [franchisor's] logo or chose to visually identify itself with the [franchisor] was left to its own discretion"). The court in *Contentinal Basketball Ass'n* relied on California's interpretation of its statute, which is also an actual use statute. *Id.* at 709 (citing *Kim v. Servosnax, Inc.*, 13 Cal. Rptr. 2d 422 (Ct. App. 1992)).

80. *Master Abrasives Corp. v. Williams*, 469 N.E.2d 1196, 1199 (Ind. Ct. App. 1984) ("The evidence presented at trial established the agreement concerned only Williams's distribution of products or services covered by Master's trademark."); *Wright Moore Corp. v. Ricoh Corp.*, 908 F.2d 128, 135 (7th Cir. 1990).

81. *Ricoh Corp.*, 908 F.2d at 135.

82. 934 F.2d 882, 886 (7th Cir. 1991) (affirming district court's refusal to find substantial association element based on mere authorization to distribute branded products because "[o]bviously, the sales of [the franchisor-branded] products are associated with the [franchisor's] trademark"). In a subsequent decision, the Seventh Circuit, without any explanation, held that there was no conflict between

Wright Moore and Hoosier Penn. Wright Moore Corp. v. Ricoh Corp., 980 F.2d 432, 435 n.3 (7th Cir. 1992) (“*Hoosier Penn* and our prior opinion herein are not irreconcilable as plaintiff suggests because the records are entirely different.”). The Seventh Circuit’s failure to actually explain how the opinions are reconcilable underscores the impossibility of doing so.

83. *Id.* (citing *Grand Light & Supply Co. v. Honeywell, Inc.*, 771 F.2d 672, 677 (2d Cir. 1985) (applying the CFA)). The Seventh Circuit also discussed one of the other Connecticut factors, citing evidence of the franchisee’s association with the franchisor such as the franchisee’s limited use of the franchisor’s trademark on letterhead, company trucks, and employee uniforms. *Hoosier Penn.*, 934 F.2d at 886. At least one subsequent court applying Indiana law has found substantial association where the evidence revealed the type of “close association” between the franchisee’s business and the franchisor’s trademark contemplated by the Connecticut/Michigan approach. *RWJ Cos. v. Equilon Enters., LLC*, 2005 WL 3544295, at *6 (S.D. Ind. Dec. 28, 2005) (finding substantial association where agreement required “extensive use” of the franchisor’s trademark in the franchisee’s business and prohibited the franchisee from selling competing products).

84. Requiring some evidentiary showing that the franchisee’s business is in fact associated to a significant degree with the franchisor’s trademark is appropriate not only because Indiana has an actual use statute but also because Indiana’s statute expressly excludes fractional franchises from the definition of a franchise. IND. CODE § 23-2-2.5-1(a)(3); *see also* discussion *infra*.

85. MD. CODE REGS. 02.02.08.02(D); *see also* WIS. ADMIN. CODE DFI-Sec. § 31.01 (6).

86. There appears to be only one published administrative opinion applying the substantial association element under the Wisconsin statute. *See In re KIS Corp., Bus. Franchise Guide* (CCH) ¶ 8,731, at 23 (Wis. Comm’r of Sec. Dec. 24, 1986). In that matter, the Wisconsin Commissioner of Securities found both factors present (trademark used to enhance prospects of success and suggested payment into advertising) and therefore concluded that the agreement was substantially associated with the franchisor’s trademark. *Id.*

87. Slade, *supra* note 23, at 7.

88. R.I. GEN. LAWS § 19-28.1-3; VA. CODE ANN. § 13.1-559.

89. *In re Neil Patrick McNulty Sr., Cease and Desist Order* (R.I. Dep’t of Bus. Reg., Sec. Div. Jan. 20, 2011), available at http://www.dbr.state.ri.us/documents/decisions/SD-Cease_and_Desist-McNulty.pdf (finding parties’ agreement substantially associated with a trademark where agreement granted franchisee right to offer franchisor’s trademarked program); *see* *Crone v. Richmond Newspapers, Inc., Bus. Franchise Guide* (CCH) ¶ 9,473 (Va. Ct. App. Sept. 22, 1989) (suggesting, in dicta, that the allegation in a complaint that the parties’ contract granted the distributor the right to sell defendant’s newspaper would satisfy the substantially associated element of a franchise). *But see* *Litton Indus. Prods., Inc. v. J.H. Elliott Co., Bus. Franchise Guide* (CCH) ¶ 7,585 (Va. Cir. Ct. Dec. 9, 1980) (holding that agreement was not substantially associated with plaintiff’s trademark where agreement did not mandate that the sales of plaintiff’s trademarked products by defendant be substantially associated with plaintiff’s trademark).

90. *Aristacar Corp. v. Att’y Gen. of N.Y.*, 541 N.Y.S.2d 165 (1989) (applying New York statute and holding that franchisee’s business

was substantially associated with franchisor’s trademark where business was only generated through calls made directly to franchisor, and thus success of both franchisee and franchisor was inextricably intertwined with the trademark); *Atchley v. Pepperidge Farm, Inc.*, 2012 WL 3044169, at *5 (E.D. Wash. July 24, 2012); *see also* Cal. Dep’t of Corps., Comm’r Op. No. PL/37F (Aug. 6, 1971) (finding substantially associated element satisfied where franchisee’s business is reliant on franchisor’s trademark).

91. *Nat’l Survival Game of N.Y., Inc. v. NSG of LI Corp., Bus. Franchise Guide* (CCH) ¶ 9,294 (N.Y. Sup. Ct. Nov. 14, 1988) (applying New York statute and holding that franchisee’s business was not substantially associated with franchisor’s trademark where evidence demonstrated that franchisee’s operation of its business was not reliant on franchisor’s trademark); *Atchley*, 2012 WL 3044169, at *5 (applying Washington statute and holding that agreement’s grant of authorization to use trademark, without additional evidence of degree to which franchisee in fact used or relied upon franchisor’s trademark, created a fact question as to whether franchisee’s business was substantially associated with franchisor’s trademark). The court’s decision in *Atchley*, while correctly noting that some evidence of actual association with the franchisor’s trademark is a prerequisite to show substantial association, appears to be an erroneous application of the summary judgment standard. Once the franchisor submitted evidence showing that the agreement merely authorized but did not require use of the trademark, the burden should have shifted to the franchisee to submit evidence demonstrating that the franchise act applied, which would include evidence that the franchisee’s business was in fact substantially associated with the franchisor’s trademark. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322–23 (1986) (holding that although the party moving for summary judgment bears the initial burden of showing that no genuine issue of material fact exists, once that burden is met, the nonmoving party must come forward with specific facts to rebut that showing). Mere “metaphysical doubt as to the material facts” is not enough. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986).

92. Like Michigan, New York has adopted a product distribution statute. *Compare* MICH. COMP. LAWS § 445.1502(3), with N.Y. GEN. BUS. LAW § 681. Presumably, mere authorization to sell the franchisor’s branded products should be sufficient to satisfy the substantial association requirement. Yet courts in both Michigan and New York have adopted a more restrictive reading of their respective statutes, requiring some showing of actual, significant use of the franchisor’s trademark by the franchisee in the operation of its business. *See, e.g., Jerome-Duncan, Inc. v. Auto-By-Tel, LLC*, 176 F.3d 904, 911–12 (6th Cir. 1999); *Nat’l Survival Game of N.Y., Bus. Franchise Guide* (CCH) ¶ 9,294.

93. STAFF REPORT, *supra* note 12, at 270 (“[A]bsent federal legislation evidencing a clear intent from Congress to occupy the field of pre-sale franchise disclosure, the revised Franchise Rule would not affect state laws providing greater consumer protection.”); *see also* Uniform Franchise and Business Opportunities Act (1987); Model Franchise Investment Act (N. Am. Sec. Adm’rs Ass’n 1990); Douglas C. Berry, David M. Byers & Daniel J. Oates, *State Regulation of Franchising: The Washington Experience Revisited*, 32 SEATTLE U. L. REV. 811, 826 (2009) (“Today, both the [Uniform Franchise and Business Opportunities Act] and [the Model Franchise Investment Act] have been resigned to the dustbin of history. Neither the UFA

nor the MFIA have retained the continued support of their respective drafting bodies, and there are no efforts underway to enact either of them.”).

94. Thus, for example, Michigan and New York should apply the product distribution approach currently employed by Rhode Island; Rhode Island should apply the authorized use approach currently employed in California and (at least by some courts) in Illinois; and California, Illinois, and Virginia should apply the actual use approach currently employed in Connecticut and Michigan.

95. Absent some concrete and explainable justifications for departing from established precedent, there is unlikely to be any significant change in judicial approaches to the substantial association problem. Indeed, although judicial adherence to principles of *stare decisis* is typically commendable and appropriate, in this particular instance it has made the task of articulating a rule of general application exceedingly difficult. Indeed, the absence of legislative guidance combined with the wildly inconsistent interpretation of the substantial association element has made it virtually impossible to reconcile the differences between jurisdictions.

96. *See, e.g.*, discussion accompanying *supra* notes 27–29.

97. *See* Hartford Elec. Supply Corp. v. Allen-Bradley Co., 736 A.2d 824 (1999); *see also* Grand Light & Supply Co. v. Honeywell, Inc., 771 F.2d 672, 677 (2d Cir. 1985) (“Where the franchisee is completely dependent on the public’s confidence in the franchised product for most or all of his business, abrupt severance of the franchise tie, without good cause and without sufficient notice, could spell ruin.”).

98. 16 C.F.R. § 436.1(g). To fall within the ambit of the fractional franchise exemption, the parties also must demonstrate that the would-be franchisee has an officer or director with relevant personal experience in the franchisor’s industry. *Id.* This additional requirement relates primarily to the relative experience of the franchisee and the informational imbalance that often plays a factor in the need for disclosure. SBP, *supra* note 1, at 59,707 (“The franchisee’s experience . . . reduces the ability of the franchisor to mislead the franchisee through incomplete or inaccurate disclosure.”). As such, it is not relevant to the question of the degree of the franchisee’s association with the franchisor’s trademark.

99. 16 C.F.R. § 436.1(g). Dollar volume of gross sales is the appropriate metric for measuring the franchisee’s dependency because it deemphasizes the total number of sales (such as high-volume, low-priced items) and allows for a direct comparison with sales of lower-volume (but higher-priced) products. *See* Leonard D. Vines, Beata Krakus & Karen Satterlee, *Fractional Franchise Exemption: Friend or Foe?*, 30 *FRANCHISE L.J.* 72, 78 (2010).

100. SBP, *supra* note 1, at 59,707 n.84 (“The Commission believes that 20 percent is a reasonable cut off point because investments beyond that amount are of sufficient import to adversely affect the entire business of the franchise as well as being a significant loss in and of themselves.”); *see also id.* at 59,707 (“[B]ecause at least 80 percent of the franchisee’s sales are derived from other products . . . the franchisee is not substantially dependent on the sales of the franchised products for his own success.”); FTC Informal Staff Advisory Op. 94-8, Bus. Franchise Guide (CCH) ¶ 6,464 (Dec. 21, 1994) (same). Incorporating the FTC’s *fractional franchise* definition into the substantial association analysis is also consistent with the laws of several jurisdictions, which explicitly exclude business relationships

from the definition of a franchise if sales of the franchised product or service are less than 20 percent of the franchisee’s dollar volume of gross sales. 815 *ILL. COMP. STAT. ANN.* 705/3; *IND. CODE* § 23-2-2.5-1(a); *VA. CODE ANN.* § 13.1-559(B). Indeed, the FTC relied upon Virginia’s 20 percent threshold in arriving at the percentage figure set forth in the federal rule. SBP, *supra* note 1, at 59,707 n.84.

101. The fractional franchise exemption has been a part of the FTC Franchise Rule since its original adoption in 1979. SBP, *supra* note 1, at 59,620. As a result, regulators have long ago resolved issues regarding the proper interpretation of the fractional franchise exemption that remain an open question in the substantial association analysis. For example, although franchisees and franchisors continue to battle over whether courts should consider sales at the franchisee’s franchise and nonfranchise businesses in the substantial association analysis, that issue has been resolved under the fractional franchise exemption. *FED. TRADE COMM’N, FRANCHISE RULE COMPLIANCE GUIDE 8–9* (May 2008), available at <http://business.ftc.gov/documents/franchise-rule-compliance-guide> (“[T]he parties may measure incremental sales resulting from the fractional franchise against total sales at all stores owned by the franchisee (franchised or non-franchised). For example, an individual owning several hardware stores may introduce a new product at one store only. The store owner should measure the increase in sales attributed to the new product against the aggregate total sales volume for all products sold through his or her businesses.”).

102. *See* David E. Kirschner, *Franchise Regulation: An Appraisal of Recent State Legislation*, 13 *B.C. L. REV.* 529, 539 (1972).

103. For example, a business that is not substantially associated with the franchisor’s trademark at the inception of the parties’ relationship (precluding application of franchise registration and disclosure laws) may thereafter become substantially associated with the franchisor’s trademark several years later when the agreement is terminated (requiring application of relationship laws). The sales test’s limited review of the first year of business operations would shed little light on the extent to which a franchisee’s business is dependent upon a franchisor’s trademark decades into the parties’ business relationship.

104. Admittedly, the reason that courts continue to resort to subjective measures to quantify the franchisee’s association with the franchisor’s trademark is partly a consequence of the vagueness inherent in the word *substantial*. Indeed, the meaning of the word *substantial* can run the gamut from “considerable value” to “not illusive,” depending on the interpretation given at the time. *See* BLACK’S LAW DICTIONARY (6th ed. 1990). As a result, courts in other contexts have reached inconsistent conclusions on whether a statute’s use of the word *substantial* is intolerably vague. *Compare* *Ill. One News, Inc. v. City of Marshall, Ill.*, 477 F.3d 461, 466–67 (7th Cir. 2007) (holding that the mere use of the word *substantial* does not make a statute intolerably vague), *with* *Ellwest Stereo Theater, Inc. v. Boner*, 718 F. Supp. 1553, 1581 (M.D. Tenn. 1989) (finding *substantial or significant* unconstitutionally vague because city officials in charge of enforcing the ordinance could not define what the phrase meant); *see also* *Doctor John’s, Inc. v. City of Roy*, 465 F.3d 1150, 1159–60 (10th Cir. 2006) (collecting cases).

105. Connecticut courts have intuitively grasped this approach but have failed to apply a consistent financial metric and time range to their analyses. *See* cases cited *supra* notes 30–41.

106. By the sales test's express terms, the burden of proving that the test has been met is on both the franchisee and the franchisor. 16 C.F.R. § 436.1(g) (providing that an agreement is exempt from the FTC Franchise Rule if "the parties [must] have a reasonable basis, at the time they enter into the agreement, to anticipate that the sales arising from the relationship will not exceed twenty percent of the franchisee's total dollar volume in sales during the first year of operation"). As a practical matter, however, in a dispute between a plaintiff claiming protection of franchise laws, the franchisor will always bear the burden of proving that it had a reasonable basis to conclude that the franchise statute did not apply. *See Vines et al.*, *supra* note 99, at 78 (noting that although the FTC fractional franchise exemption places the burden on both franchisor and franchisee to make a reasonable good faith determination of franchisee's projected sales, "[a]s a practical matter, the franchisor is the one ultimately responsible for compliance with federal and state franchise laws").

107. One counterargument to adopting the modified sales test is that it would only replace one subjective test (measuring the closeness or degree of association between the franchisee's business and the franchisor's trademark) with a different subjective test (whether the franchisor had a reasonable basis for believing that the percentage of the franchisee's business was below the specified amount). *See Vines et al.*, *supra* note 99, at 80–81 ("How detailed do the projections have to be? What basis must the parties have for their projections? It is clear that the parties do not need to involve an accountant, but what research and analysis gives rise to a good faith belief?"). But there are many authorities interpreting the sales test under the fractional franchise exemption and, in particular, whether the franchisor has a reasonable basis for concluding that less than 20 percent of the franchisee's business in the following year would be attributable to sales under the trademark. FTC Informal Staff Advisory Op. 99-5, Bus. Franchise Guide (CCH) ¶ 6,502 (July 2, 1999) (finding that franchisor had a reasonable basis for concluding that the 20 percent test was satisfied where franchisor required prospective licensees to prepare projections of the amounts and sources of their revenue and franchisor evaluated the reasonableness of the projections before accepting them); FTC Informal Staff Advisory Op. 97-1, Bus. Franchise Guide (CCH) ¶ 6,481 (Nov. 5, 1996) (finding that the mere statement that the parties anticipate that franchisee's

sales will not exceed the 20 percent threshold is likely insufficient to satisfy the sales test). Although the reasonable basis element of the modified sales test is not perfect, it would represent a drastic improvement over the wildly different substantial association tests that are currently applied across the country.

108. Placing the burden on the franchisee of notifying the franchisor of any change in the franchisee's circumstances also avoids the unintended effect of vesting the franchisee with the power to create a franchise relationship by voluntarily electing to transfer product lines to different, affiliated businesses. *See discussion supra* note 35.

109. The rule would therefore be similar to the regulations promulgated in Illinois. *See ILL. ADMIN. CODE* tit. 14, § 200.103 (noting that "[a] contractual prohibition on use of the franchisor's name or mark must be policed and enforced to insure that the name or mark is not being substantially used without the franchisor's knowledge").

110. David J. Meretta & Eric H. Karp, *Regulation FD: Roadmap to Better Relations Between Franchisors and Franchisees*, 26 *FRANCHISE L.J.* 117 (2007) ("Open communication and collaboration among franchisors and their franchisees are important ingredients for system success and extremely beneficial for everyone concerned. In fact, beyond merely being desirable, a structure that delivers efficient, effective, and formal franchisee participation in system governance is essential for franchise-based business organizations to flourish in the long term.").

111. Many product distribution agreements have little or no documentation and are instead evidenced only by purchase orders and invoices. Such arrangements are already very easy to terminate as there is no written contract between the parties that would impose termination obligations or restrictions.

112. Such a reporting system would likely make a distributor reluctant to disclose the changes in its business for fear of losing even more revenue as the manufacturer scales back deliveries to avoid franchise regulations. But the failure to make a required disclosure would also imperil the distributor's ability to claim the protection of franchise laws in the future. The rule therefore corrects the informational imbalance and permits the distributor to make its own decision to report or not to report its sales based on its own assessment of the risks.

113. *See sources cited supra* notes 50, 67.