

Did We Accidentally Create a Franchise?

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Venturing into the world of licensing may allow business owners to do their true, idea-based expansion without plunging into the complexities and legal requirements of franchising.

License agreements appeal to fast-moving entrepreneurs eager to speed into seemingly simple agreements at a lower cost, unlike the **lengthy disclosure documents and higher upfront legal costs** that are known to accompany franchise agreements.

Here is the plot twist, though – the line between a trademark licensing arrangement and a franchising arrangement can easily and unknowingly blur, and unsuspecting business owners can find themselves tangled in a web of federal and state franchise laws when they intended to enter into a "straightforward" trademark license.

Further, businesses may not only blur the line with franchise laws but also find themselves crossing the line with other intellectual property owners. Business owners eager to expand geographically often underestimate the risk and significant expense of trademark infringement.

Thus, we encourage business owners excited by the opportunity of brand expansion to step back to:

- Evaluate the scope, availability, and risks associated with their intellectual property rights.
- Understand the difference between a license and a franchise.
- Carefully navigate and evaluate the legal requirements of licensing

and franchising before proceeding with either option.

A business that tries to cut corners, save on upfront costs, and ends up confusing the two may find itself lost in unintended and expensive consequences, including the "accidental franchise."

Understanding the Difference

Before embarking on the journey to avoid the accidental franchise pitfall, let's clarify the key differences between a license agreement and a franchise.

- A license agreement grants a third-party permission to use intellectual property, such as trademarks, copyrights, trade secrets, or patents, within very specific parameters to protect the intellectual property.
- A franchise agreement, in contrast, not only grants permission for intellectual property use but also establishes a much more detailed relationship between the parties. Think operational support, ongoing training, and a substantial level of control over the franchisee's business operations.

Often, business owners who want to permit third-party use of their intellectual property desire to control **too much** of that third-party business in return, turning a license into a franchise by accident. Licensors do need to exercise a degree of quality and uniformity control to avoid loss or abandonment of intellectual property rights. However, too much control – or control that is not tied to the licensed brand – blurs the line. As a result, the business owner of an accidental franchise may be subject to legal action for violating franchise laws.

In order to avoid creating an accidental franchise, licensors should strategically do the following:

In the franchise universe, operational control is king. Franchise agreements include pages of **detailed guidelines stipulating how the business should be run**, with provisions including, for example, the type of training employees should receive, what suppliers must be used, and specific

inventory and pricing requirements.

In contrast, a license agreement should maintain and respect the licensee's autonomy and business judgment. The licensor may exercise control solely for the purpose of protecting its intellectual property and maintaining its brand standards. Such "quality control" provisions may include, for example, use of proper ownership notices, licensor approval of advertisements, and/or site inspections. However, licensors should avoid providing ongoing support or training and refrain from providing assistance in business operations, employee matters, or management decisions.

Franchisors typically impose strict marketing and advertising rules across all locations, such as spending a minimum amount on advertising in specified channels or working with a specific advertising company. License agreements should refrain from imposing these requirements, allowing licensees the flexibility to market and sell products or services in a manner that suits their business model.

However, licensors can (and should) impose aesthetic or use requirements to maintain the integrity of their brand. The licensor may specify aesthetic standards to ensure consistency in the visual representation of the brand, such as guidelines on the use of logos, color schemes, fonts, quality of materials used, and other visual elements to maintain a cohesive and recognizable brand image across all licensee products or services. A licensor may also define specific contexts – such as specific territories, trade channels, customers, industries, and/or products - in which the intellectual property can (or cannot) be used to maintain the integrity of the brand.

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