REPORT BY HOSPITALITY LAW COMMITTEE

The Accidental Franchise and the New York Restaurateur

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I. INTRODUCTION

Why should a New York restaurateur that does not advertise itself as a "franchisor" be concerned about franchise laws? The answer is simple. Most restaurateurs and other businesspeople (and in fact, many attorneys) are oblivious to the fact that federal and state franchise laws extend beyond traditional franchisors, such as those engaged in the fast food, hotel/motel and convenience store sectors of our economy. Franchise laws generally define the terms "franchise" and "franchisor" so broadly as to embrace businesses, business relationships, licenses and distribution methods that seem to have nothing to do with traditional franchising. Accordingly, both federal and state franchise regulations apply in New York to any arrangement, whether it is called a "franchise" or not, that fits the definition of franchise under either federal law or the New York State franchise law. Therefore, many restaurants and other businesses can "accidentally" be subject to franchise law. And the consequences of non-compliance with these regulations can be significant.

The following are a few documented examples of unwitting franchisors and their "surprise" franchisees who have faced legal issues as a result of their accidental franchise. Some are cases from New York; others are from states other than New York that have franchise laws that are similar in nature:

- A radio dispatched "upscale" car service was a franchisor and its drivers were franchisees under the New York Franchise Act.[1]
- A sports information service was held to be a "franchisor" and one of its distributors was a "franchisee" under the New York Franchise Act.[2]
- An appliance manufacturer was held to be a "franchisor" and one of its distributors was a "franchisee" under the New Jersey Franchise Practices Act.[3]
- An office furniture manufacturer was held to be a "franchisor" and one of its dealers was a "franchisee" under the Missouri Franchise Law.[4]
- A boat manufacturer was held to be a "franchisor" and one of its dealers was a "franchisee" under the California Franchise Relations Act.[5]
- A baked goods manufacturer was held to be a "franchisor" and its route distributors were "franchisees" under the Connecticut Business Opportunity Act (which regulates franchising).[6]
- A forklift truck distributor was held to be a "franchisor" and one of its dealers was a "franchisee" under the Illinois Franchise Disclosure Act.[7]

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[1] *Aristacar Corp. v. Attorney General of New York,* 143 Misc.2d 551, 541 N.Y.S.2d 165 (N.Y. Sup. Ct., N.Y. Cty. 1989).

[2] *King Computer, Inc. v. Maschler,* Bus. Franchise Guide (CCH) ¶10,182, not reported in F.Supp. (S.D.N.Y. 1993).

[3] *Cooper Distributing Co. v. Amana Refrigeration, Inc.*, 63 F.3d 262 (3rd Cir. 1995).

[4] *American Business Interiors Inc. v. Haworth Inc.*, 798 F.2d 1135 (8th Cir. 1986).

[5] *Boat & Motor Mart v. Sea Ray Boats, Inc.*, 825 F.2d 1285 (9th Cir. 1987).

[6] *Petereit v. S.B. Thomas, Inc.*, 63 F.3d 1169 (2d Cir. 1995).

[7] *To-Am Equipment Co., Inc. v. Mitsubishi Caterpillar Forklift America*, 152 F. 3d 658 (7th Cir. 1998).

- A furniture distributor was held to be a "franchisor" and one of its dealers a "franchisee" under the Illinois Franchise Disclosure Act.[8]

Accordingly, it is vital that any business which either engages in licensing activity and/or distributes products or services through independent third parties conduct detailed analyses of the varying definitions of the term "franchise" found both in the Franchise Rule of the U.S. Federal Trade Commission (FTC) and the fifteen state franchise registration/disclosure statutes, lest that business' activities fall within the ambit of such laws. If that business (such as a restaurant) engages in activities that fall within the embrace of such laws, they may render the business an "unwitting" franchisor subject to governmental attack, the plethora of criminal and civil penalties which apply to illegal franchising (and, as always, ignorance of the law is no excuse), and private rights of action commenced by "franchisees" unhappy with their business relationships. This is particularly vital in New York because, as we explain below, New York's franchise statute has the broadest definition of "franchise" of any franchise law in the nation.

a. Background on Franchising in the Restaurant Industry

In the 1950's and 1960's, the quick-serve and fast-casual restaurant giants entered the scene and franchising became big in the food service industry. Pizza Hut, McDonald's, Burger King, and Kentucky Fried Chicken are only a few of the now famous companies that franchised during this explosive period and continue to do so today. Indeed, many restaurant chains – not just quick-serve or fast casual, but also full-service restaurant dining – which started as single, privately-owned restaurants are now offered as franchises. Older brands of this sort include, for example, T.G.I. Fridays (which started as a single, privately owned location in New York City in 1965 and began franchising in 1988);[9] Benihana (which began in New York in 1964 as a small, privately owned Japanese restaurant and has since offered and sold franchises for sushi and Japanese steakhouse restaurants in many states);[10] Sbarro's (which began as an Italian grocery store in Brooklyn about 60 years ago and now has over 600 restaurant locations around the world, specializing in "New York" style pizza);[11] and the Greene Turtle Sports Bar & Grille (which began in Maryland in 1976, began franchising in 2004 and offers franchise opportunities in New York State among other places).[12] Newer restaurant franchises include, for example, Bareburger restaurants (which started as a small, privately owned bar/music venue in Brooklyn in 2002 that also served organic hamburgers, and then branched out into franchising);[13] and BonChon Chicken (which started in Korea as a family-owned business, expanded to New Jersey

8 *Bly & Sons, Inc. v. Ethan Allen Interiors, Inc.*, 2006 WL 2547202, not reported in F.Supp.2d (S.D. Ill. 2006).

9 https://www.franchisehelp.com/franchises/tgi-fridays/; http://usa.tgifridays.com/ (All websites cited in this letter were last visited on April 22, 2019.).

10 https://www.benihana.com/about/franchising/

11 https://franchise.sbarro.com/AvailableLocations

12 https://thegreeneturtle.com/about/franchise-information/

13 https://www.allusafranchises.com/food-franchises/hamburgers-franchises/bareburger.htm

in 2006, and then entered New York City, where it now has its flagship restaurant and U.S. headquarters and from which it has offered and sold franchises in various states).[14]

Ironically, however, the very popularity, growth and economic rewards of franchising (both to franchisors and franchisees) led to the need for its regulation. This is because by the late 1960's and early 1970's, the words "franchise" and "fraud" had almost become synonymous. As franchising exploded on the scene in the 1950's and 1960's, story after story appeared in newspapers and magazines about how franchisors and franchisees were growing phenomenally wealthy in this burgeoning arena. That is when the criminal community – including organized crime – jumped in. Using slick brochures and outright fraud, these criminals sold phantom, non-existent franchises to hapless victims. Tens of thousands of people nationwide collectively lost millions of dollars through criminal franchise enterprises.

In 1971, California took the lead in fighting franchise fraud by enacting its revolutionary "Franchise Investment Law," which was loosely modeled on state and federal securities laws and was premised upon the principle of protecting investors by giving them information necessary to make informed investment decisions. Under the new California law, for the first time a franchisor had to register itself; prepare and register a franchise disclosure document; and distribute that document to prospective franchisees well before taking their money or having them sign any contract, under threat of both criminal and civil liability. Other key states followed: Maryland, Virginia, Wisconsin, Illinois, Minnesota, Indiana, North Dakota, South Dakota, Michigan, Hawaii, Oregon, Washington and Rhode Island.

The most recent state franchise disclosure law, the New York Franchise Act, was enacted in 1980, and is still in force today.[15]

And at the federal level, there are federal franchise laws that apply throughout the United States, and its territories and possessions. In October of 1978, after many years of study and review, the FTC Franchise Rule was promulgated, under which franchisors throughout the nation had to engage in franchise disclosure, but without any federal registration requirement.

The goal of these franchise laws was and is to eradicate fraud and eliminate criminals and organized crime from the franchise arena. And by and large, they have worked. Due to the diligent enforcement of these laws by federal and state regulators – who, at the same time, grew increasingly understanding of the legitimate franchisor community's needs and wants – there has not been a major franchise scandal in this country in decades. (Not that there have not been improprieties, but there has been no wide-scale fraud visited by a criminal franchisor.) State laws like the New York Franchise Sales Act played a large role in that change, giving substantial powers to the New York State Attorney General's office to pursue those who violate the statute – but also, as a result, creating a statute quite broad in its scope, that covers many activities that in everyday business lexicon are not thought of by most people as franchises. Therefore, New York

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[14] https://bonchon.com/our-story/. Full disclosure: one of the authors of this paper represents Bonchon Franchise LLC, the franchisor of Bonchon Chicken franchises in the United States.

[15] New York General Business Law (N.Y. GBL) Art. 33, Sec. 680, et seq.

restaurateurs should make every effort to educate themselves on applicable franchise laws to avoid unwittingly undertaking business activity that falls under the legal definition of a franchise.

II. WHEN IS FRANCHISE LAW COMPLIANCE NECESSARY, AND WHAT DOES IT ENTAIL?

Broadly speaking, the franchise sales laws in New York and several other states require franchise registration with the state (including an approval process) before anything deemed a "franchise" may be offered or sold. Both the federal government's and New York State's (among other states') franchise sales laws require franchisors to deliver a franchise disclosure document to each prospective franchisee.

The New York franchise statute features an elaborate registration protocol pursuant to which both the franchisor seeking to offer franchises, and the franchise disclosure document it intends to utilize to do so, are closely scrutinized and almost always commented upon by the regulator (which, in New York, as mentioned above, is the New York Attorney General's Office, also known as the Department of Law) before any franchise registration is approved – unless the franchisor qualifies for one of the exemptions from registration which most of these laws make available (more on that in Section V below). The creation of a franchise disclosure document is a cumbersome task, involving the disclosure of 23 categories of information about the franchisor (also known as "Items" – and each Item is often several pages in length), as well as audited financial statements of the franchisor entity. The document is often drafted by experienced franchise counsel who know what the state examiners are looking for and how to address the nuances of the statutory requirements.

The New York statute does not require annual renewal of a franchisor's franchise disclosure document, but it achieves the same goal by requiring franchisors which are actively selling franchises to amend their franchise disclosure documents within 120 days following the close of their most recent fiscal year. Therefore, restaurateurs who have plans, on an ongoing basis, to enter into new licensing, distributorship, or other arrangements that could be deemed a franchise also need to consider whether they need to update and renew their FDD – including new audited financial statements – each year, and consider the cost involved in doing so.

Restaurateurs and others must be aware of significant state franchise law jurisdictional "twists," on a state by state basis, considering not only where the franchised outlet/establishment will be located, but also where the franchisor is located, where the franchisee is located, and where negotiations or communications about the prospective franchise take place (including where phone calls are received or made from, where meetings occur, etc.). For example, New York takes the position that the words "in this state" in New York's franchise statute are meant to cover any franchise sales activity that actually takes place in New York, that emanates from New York, or that is directed to New Yorkers – regardless of whether the contemplated franchised business is to be located within New York. Therefore, for example, a New York franchisor which only seeks to sell franchises in California must nevertheless register in both New York and California to satisfy both states' laws.

One must consider both federal and state franchise law in determining whether a particular licensing, distributorship, or other arrangement is a franchise. The FTC Franchise

Rule defines the term "franchise" in one way, while state franchise laws define it in their own ways. Businesses must be very careful to determine which state franchise registration/disclosure laws apply to their licensing and/or franchising operations. This can prove quite a task, given that each franchise-regulating state defines the term "franchise" independently of the others, with New York affording the broadest definition of them all.

State franchise laws seek to define the term "franchise" by reflecting franchising's underlying economic realities. However, the franchise-regulating states have agreed upon no single, uniform definition, and thus the scope of coverage of each state statute must be carefully analyzed.

Most state franchise registration/disclosure statutes consider a franchise to exist when three elements are met. Specifically, these are: (1) whenever a franchisee, in return for a *franchise fee*, is (2) granted the right to sell goods or services under a *marketing plan or system* prescribed in substantial part by the franchisor (some states – New York not being among them -- describe this element more broadly as a "community of interest" between the franchisor and franchisee), and (3) the operation of the franchisee's business pursuant to that marketing plan or system is substantially associated with the *franchisor's trademark, service mark or other commercial symbol*.

New York's definition of a "franchise"[16] is in sharp contrast to that employed by every other jurisdiction, where all three elements set forth above – trademark, marketing plan (or community of interest), and franchise fee – must be present for a franchise to exist. In New York, either of the second or third elements combined with the franchise fee component will suffice. This broader definition covers many species of licenses, distributorships and other commercial relationships not otherwise subject to franchise regulation. Therefore, one must be alert to the very real possibility that certain businesses may be considered "franchisors" in the eyes of New York law even if they are not in any other franchise-regulating jurisdiction.

a. Complying with Franchise Relationship Laws

One should also note that, beyond the requirement that a franchisor meet the pre-contract disclosure requirements imposed by franchise laws, certain states have franchise "relationship" laws, which take another approach to protecting franchisees.[17] These laws impose substantive requirements that typically limit the franchisor's ability to terminate or refuse to renew without good cause. Rather than regulating disclosures at the time franchises are sold, these laws regulate the relationship between the franchisor and franchisee after the sale, and are an additional compliance burden which might apply if that state's relationship law is triggered. While New York does not have such a relationship law, bear in mind that a franchise may still trigger New York's franchise law even while the franchised business is located in another state. And the

[16] N.Y. GBL, Art. 33, Sec. 681(3).

[17] Today, the following eighteen states (in addition to Puerto Rico) have laws of general applicability that govern the franchise "relationship": Arkansas, California, Connecticut, Delaware, Hawaii, Illinois, Indiana, Iowa, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, Rhode Island, Virginia, Washington, and Wisconsin.

neighboring state of New Jersey, for instance, does have a franchise relationship law – in fact, one of the most burdensome to franchisors in the entire country, as it has been interpreted and applied by New Jersey's courts.

b. Complying with Business Opportunity Laws (if Applicable)

An additional set of laws that may apply to franchisors are those laws that regulate "business opportunities." Half of the states have business opportunity laws. What is a business opportunity? The definition varies significantly from one state to the next. Like the franchise laws, the business opportunity laws contain disclosure requirements and sometimes require a filing. Unlike the state disclosure requirements, which are largely uniform throughout the U.S., the business opportunity law disclosure requirements vary from state to state. The business opportunity laws generally contain exceptions or exemptions for franchise offerings made in compliance with the FTC Franchise Rule, and many of these laws exempt offerings that are made in connection with a federally registered trademark held by the franchisor. While an exploration of the business opportunity laws is beyond the scope of this paper, they are an additional compliance burden that a franchisor needs to consider, depending on where the franchise is offered and sold.

c. One Cannot Simply "Waive" Application of Franchise Law

It does not matter whether a business arrangement is called a franchise by the parties -- if it meets the elements of the definition, it is a franchise and the arrangement is a franchise agreement.

Under most state franchise registration/disclosure statutes, any attempts to compel a franchisee to waive any given franchise statute's provisions are deemed fraudulent and unlawful practices. That includes New York's franchise registration/disclosure statute. Therefore, including contract terms such as "franchise laws shall not apply," or "the arrangement between the parties is not a franchise", or "licensee waives its rights under any applicable franchise laws" will not have the intended effect, and will not remove otherwise qualifying business activity from the purview of applicable franchise laws.

Some business owners may attempt to get around the New York franchise statute by simply designating a different governing law, other than New York, in their contractual licensing arrangement with another party. That approach will also fail. While virtually every franchise agreement contains a "governing law" provision in which the parties agree upon which state's law will govern any dispute between them, a franchise agreement's designation of "governing law" is not conclusive. Virtually every state franchise registration/disclosure law contains an "anti-waiver" provision prohibiting any attempt by a franchisor to compel its franchisee to waive the protections afforded by the statute (indeed, under most state franchise laws, seeking to compel such a franchisee waiver of the statute's protection is itself an express statutory violation). What this means is that a franchisee almost always will be able to invoke his/her/its rights under applicable state franchise laws in any arbitration or litigation with the franchisor regardless of what the "governing law" provision of their franchise agreement says. For example, even if the franchise agreement stipulates that California law will govern all disputes, a

New York resident whose franchise is situated in New York will always have the right to invoke the New York Franchise Act's rights, remedies and damages.

The consequences of ignoring franchise regulation can be serious – including both civil and/or criminal penalties, and possibly the need to rescind the contract that is the subject of the franchise. We discuss the consequences, and how to mitigate them, in more depth below.

III. WHAT TYPES OF SCENARIOS CAN TRIP UP RESTAURATEURS?

Common scenarios that can result in restaurateurs unwittingly becoming "franchisors" might involve a licensing arrangement or distribution arrangement involving their restaurant's brand. To give the reader a sense of this, such scenarios may include (but are not limited to) the following general examples:

- Where a restaurateur, as licensor, grants a license of the trademark, service mark, or other key aspect of its brand, to a licensee to create one or more additional locations of the restaurant, or a restaurant very similar in concept and based on the same or similar recipes, or perhaps based on the same or a common appearance as the original restaurant. For instance, to finance expansion, a restaurateur might co-invest with the owner of another restaurant brand. Or, perhaps a restaurateur needs to entrust the operations of a new outlet in the hands of a local, experienced business partner in as unfamiliar geographical market, or in a non-traditional type of location (such as a restaurant in a stadium, mall or airport).

- A partnership arrangement, where the founding owners of a restaurant co-invest with others in order to open additional locations and maintain an equity interest in those other locations, where the other locations maintain use of the same trademark/brand, recipes, and/or appearance as the original location.

- An arrangement or relationship involving protected territory. For example, the founding restaurant owners sell a territory wherein others are granted the opportunity to develop restaurants in that designated territory (whether established under a licensor/licensee arrangement, as in example "(i)" above, or a partnership arrangement, as in example "(ii)" above). Or, perhaps this is done under another type of "territory" grant, such as granting the right to sell products of the restaurant's brand (such as the restaurant's special sauce, spice mixes, soups, signature pastries, or desserts) within a particular territory -- such as from food trucks, ice cream trucks, or the like.

- Distributorship arrangements where a restaurateur grants one or more parties the right to sell the restaurant's branded products to other restaurants, gourmet grocery stores, supermarkets or other vendors for resale to the general public.

- "Joint ventures" (a term lacking a precise legal definition) where a new entity is created, say, to open a new restaurant together with another investor, and has licensed an existing restaurant brand's concept, know-how, recipes, etc. for that purpose. Perhaps the trademark license is simply implied, or oral, or based on a handshake. Perhaps there is significant operating control or involvement in the joint venture by the owner of the existing restaurant brand. Perhaps there are required payments to the licensor of the intellectual property of that existing restaurant brand, although not framed in that way (for instance, perhaps it is just a right to participate in profits from the joint venture).

In the above types of situations and more, a New York restaurateur should consult with franchise counsel before proceeding, in order to determine what actions, if any, are needed in order to comply with franchise laws. We discuss one hypothetical example in more detail in Section VII.

IV. EXAMINING NEW YORK'S DEFINITION OF 'FRANCHISE' IN THE RESTAURANT CONTEXT

As mentioned above, the New York Franchise Act is perhaps the nation's most onerous franchise law. One key reason for this view is that New York's definition of the term "franchise" is the broadest in the nation, subsuming certain licensing, distribution and other arrangements that are not deemed to be "franchises" under any other federal or state franchise law, rule or regulation.

New York considers a "franchise" to exist in either of two circumstances: (i) where a franchisee, in return for a "franchise fee," is granted the right to sell goods or services under a marketing plan or system prescribed in substantial part by the franchisor, or (ii) where a franchisee, in return for a "franchise fee," is granted the right to sell or distribute goods or services substantially associated with the franchisor's trademark, logo, advertising or other commercial symbol.[18] We quote the full definition under New York's franchise law in Appendix 1 to this paper.

Counsel must be alert to the very real possibility that a client's licensing activities, distribution methods and/or retail protocols may unwittingly render it a "franchisor" in the eyes of New York law and therefore require the client to comply with the New York Franchise Act's requirements.

a. Franchise Fee

Critical to determining whether a licensing or other business arrangement falls within the embrace of the New York Franchise Act is whether the statutorily required "franchise fee" is present. Simply stated, if there is no franchise fee paid or payable, there is no "franchise" under the New York Franchise Act. It thus becomes vital to determine just what constitutes a "franchise fee" under the New York Franchise Act. This question is addressed in detail in the New York Franchise Regulations,[19] which make clear that:

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[18] New York Franchise Act, N.Y. GBL § 681(3).

[19] 13 NYCRR Ch. VII, §§ 200.1, et seq.

> A franchise fee includes, but is not limited to, payments that are made before, upon, or after execution of an agreement to purchase, process, resell, or otherwise distribute a manufacturer's, a distributor's or a licensor's goods, services, equipment, inventory or real estate. The word 'payment' includes those made in the form of a lump sum, installments, periodic royalties, profits, cash flow, or those reflected in the price of goods, services, equipment, inventory or real estate sold or leased by the manufacturer or licensor to the distributor or licensee respectively.[20]

A few notes on what are <u>not</u> considered franchise fees:

- The New York Franchise Act makes clear that the payment for goods at bona fide wholesale prices does not constitute the payment of a "franchise fee."
- Also, in New York, the franchise law permits up to $500 in fees to be paid annually without finding a "franchise fee" – if sales materials of equal or greater value are received by the franchisee.[21]
- Further, ordinary and necessary business expenses are not franchise fees. *<u>See</u> In re The Matterhorn Group, Inc*., 2000 Bankr. LEXIS 915 at 30 (U.S. Bankr. Ct. S.D. N.Y. 2000), at 32 (applying New York law).

If a restaurateur enters into an arrangement where they are to receive ongoing royalties, they should consider whether that would be deemed a franchise fee. But a franchise fee can include many other things as well, such as a lump sum payment (the most obvious), a right to a portion of profits or cash flow, or fees reflected in the price of goods, services, equipment, inventory, or other items. Importantly, the payment need not be paid up-front to be considered a franchise fee; it can be paid over time. Indeed, it can include payments made before, upon, or after signing the relevant agreement. The "franchise fee" element can be met by a restaurateur's agreement to purchase, process, resell, or otherwise distribute a restaurant's goods. And unlike the FTC Rule and some other states' franchise statutes, in New York there is no exemption for situations where the fee is deferred until a later time.[22]

b. Marketing Plan

As to what constitutes a "marketing plan" necessary to bring a business relationship within the purview of the New York Franchise Act, the New York franchise regulations state:

> A 'marketing plan' is advice or training, provided to the franchisee by the franchisor or a person recommended by the franchisor, pertaining to the sale of

[20] *Id*. at §200.1(a).

[21] N.Y. GBL § 681.7(e).

[22] In some states, if no commitment to pay a franchise fee is made within the first six months of operation, then the franchise registration and disclosure requirements do not apply, but that is not the case in New York.

> any product, equipment, supplies or services and the advice or training includes, but is not limited to, preparing or providing: (1) promotional literature, brochures, pamphlets, or advertising material; (2) training regarding the promotion, operation or management of the franchise; or, (3) operational, managerial, technical or financial guidelines or assistance.[23]

One must consider the totality of the arrangement between the restaurateur and the counterparty. This is because the New York Franchise Act makes clear that the registration and disclosure requirements mandated therein apply to all written or oral arrangements between a franchisor and a franchisee in connection with the offer or sale of a franchise – that is, not just the document that is deemed to be a "franchise agreement", but also the sale of goods or services; leases and mortgages of real or personal property; promises to pay; security interests; pledges; insurance; advertising; construction or installation contracts; servicing contracts; and, all other arrangements in which the franchisor may have an interest.[24]

c. A Franchised Business Need Not Be in New York for New York's Franchise Law to Apply

Note that New York's franchise law can apply in situations where the restaurant is not even in New York – if the franchisor is from New York (the offer originates from New York), makes phone calls about the offer from or sends emails or faxes from New York, etc. Indeed, nothing in the New York Franchise Act triggers applicability of such act or the rules or regulations promulgated thereunder simply because a franchised operation is to be located in New York. Rather, the trigger is where the contracting parties are each based, and where the offer is made or accepted. The New York franchise statute lacks the type of out-of-state sales exemption that state franchise laws in other states usually have. Under the New York Franchise Act, an offer or sale is considered made in the state when the actual offer is made in the state, the offer is accepted in the state, ***<u>or</u>***, if the franchisee is domiciled in New York State, the franchised business is or will be operated in the state. It is also made in the state when the offer originated from the state or is directed by the offeror into the state and received in the state.[25] Notably, New York's franchise law applies even where the franchisee is neither domiciled in the state nor will be operating a franchise in the state; any negotiations in New York of a franchise agreement, even if otherwise unrelated to the state, will be subject to its franchise law. Also, a franchisor who is located in New York, but does not sell franchises in the state, would still be required to register in New York before being able to legally sell franchises in any state.

d. Why Is New York's Definition of Franchise So Broad?

The New York Franchise Act was crafted to attack heightened criminal activity in the franchise arena which transpired in the 1960's and 1970's (including significant organized crime involvement) and to safeguard New York's reputation as the financial capital of the world.

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[23] 13 NYCRR Chapter VII, § 200.1(b).

[24] N.Y. GBL, § 682.

[25] *Id*., § 681(12).

Hence, the New York Franchise Act was drafted broadly in order to crack down on criminal activity involving franchising, and since its passage it has been a huge success in this regard. Indeed, it has proven enormously beneficial to the many legitimate franchisors doing business in this state.

While it seems that the days of entire franchised chains being owned by, or for the benefit of, various organized crime families are long gone, there was a time when this was a major problem in the food service industry. For example, decades ago, certain bagel and sandwich franchise networks were determined to have organized crime roots. Indeed, the situation got so bad that in 1978, the famous television news magazine <u>60 Minutes</u> did a "take down" piece on franchising. The focus of <u>60 Minutes</u> was Wild Bill's Family Restaurants. Roaming the metropolitan area in two rented Rolls Royce sedans and promising prospective franchisees that they, too, could afford luxury cars if they bought a franchise, the two principals of Wild Bill's fleeced many. Not a single Wild Bill's restaurant ever opened. Its two principals ultimately were indicted for fraud and racketeering. It was to address this sort of problem that the New York Franchise Act was conceived and enacted.

The New York Franchise Act's scope, applicability, enforcement mechanism, penalties and requirements make it the toughest franchise registration and disclosure statute nationwide. And its extraordinary scope was explicitly demanded by Attorney General Robert Abrams, since fraudulent "franchisors" would frequently not identify themselves as such but, instead, would package their franchise schemes as "joint ventures," "employment contracts," "shareholders' agreements" or otherwise. The purpose of the New York Franchise Act's extraordinarily broad definition of the term "franchise" was to encompass and eradicate every species of franchise fraud that could victimize New Yorkers—regardless of the nomenclature employed.

The New York Attorney General's Franchise Section, which is the state regulator of franchise offers and sales, has worked for decades to foster legitimate franchising in New York State and assist legitimate and reputable franchisors. Under the leadership of Assistant Attorney General Joseph Punturo and with a sophisticated staff, most of whom have been on the job for decades, the Franchise Section of the Attorney General's office has, over the years, dramatically accelerated the franchise registration process and has made New York a welcome haven for legitimate franchisors while valiantly serving to protect the interests of franchisees.

V. WHEN EXEMPTIONS FROM FRANCHISE LAW MAY APPLY

Here we briefly explore certain exemptions available under the New York franchise statute and the rules and regulations promulgated thereunder. Technically, to be able to apply any of these state-level exemptions, one must also consider whether a pertinent relevant federal franchise law exemption applies; however, with respect to each exemption listed below, that is the case.

While a detailed discussion of these exemptions is beyond the scope of this paper, a restaurateur will want to carefully explore whether exemptions can be utilized, and the nuances of each relevant exemption, if they wish to use an exemption to avoid the need for franchise registration and/or disclosure procedures in New York.

a. Isolated Sales Exemption

New York's Franchise Act has an exemption from its franchise registration requirements for isolated franchise sales in the state. Specifically, a single franchise sale is exempt from registration if it is not offered to more than two persons, no right to offer to others is granted, no commission or remuneration is paid directly or indirectly to solicit a prospective franchisee, and the franchisor is domiciled in New York and files a consent to service of process with the Department of Law. Note that this exemption does not relieve a franchisor of compliance with the anti-fraud provisions of the state franchise law – just from the disclosure and registration requirements. This is intended as an exemption for a franchisor to be able to "test the waters," so to speak, in New York State with a single franchisee before it decides whether to expand beyond that. It is not intended as a catch-all method for an accidental franchisor to avoid complying with New York's franchise law.

b. Fractional Franchise Exemption[26]

An offer or sale of a franchise is exempt from both the franchise registration requirement in New York and the pre-sale franchise disclosure requirement in New York, if it is a "fractional franchise." A fractional franchise means a franchise adding a new product or service line to the existing business of a prospective franchisee, where conditions regarding franchise experience, product similarity, location, sales percentages, and franchisor control are met.[27] Specifically, the franchisee or an existing officer, director, or managing agent holding the position for the last 24 months, must have been engaged in business offering products or services substantially similar or related during the past 24 months; the new product or service must be substantially similar or related to the product or service then being offered by franchisee; the parties must anticipate in good faith that sales will represent 20% or less of the franchisee's total sales in dollar volume on an annual basis; the franchised business is to be operated from the same location as the franchisee's current business; and, the franchisee must not be controlled by the franchisor. For this exemption to apply, the franchisor must file a notice with the New York Department of Law and pay a one-time filing fee.

This exemption may be of use to restaurateurs who offer licensing rights to someone where the rights to be used will constitute a relatively small part of the restaurant or food service related business of the licensee at that location.

[26] New York Department of Law, Bureau of Investor Protection and Securities – Codes, Rules and Regulations of the State of New York, Title 13, Sec. 200.10(2).

[27] NY Comp. Codes R. & Regs. Sec. 100.10(2).

c. Renewal, Extension, Amendment or Modification[28]

Under New York's franchise statute, there is an exemption from registration and disclosure requirements for a renewal, extension, amendment, or modification of an existing franchise agreement. No filing is required for this exemption to apply.

However, for this exemption to apply, there must be no interruption or change in the operation of the franchised business by the franchisee. Note that if the franchisee is required to sign the franchisor's then-current form of franchise agreement and such terms differ from the previous form, then this exemption may not apply. As a practical matter, in such cases the franchisor should have the franchise disclosure document (FDD) registered and deliver the then-current FDD to the franchisee.

d. Sale by Existing Franchisee[29]

New York has an exemption for a franchise sale by an existing franchisee (for example, transferring the franchised business to a new party). The sale cannot be effected by or through the franchisor itself (that would trigger a disclosure to the transferee of a current franchise disclosure document). However, the franchisor may reserve a right merely to approve or disapprove the choice of new franchisee, without triggering such requirement. It must be an isolated sale and the franchisee must provide the prospective purchaser with full access to the franchise books and records in the possession of the existing franchisee.

This exemption may be somewhat confusing to some, because although it is an exemption from registration, as well as an exemption from disclosure by the franchisor, it still technically requires the existing franchisee to furnish to the prospective purchaser a copy of the franchise disclosure document registered with the Department of Law. The statute does not explain what the franchisee is to do when the franchise offering is no longer registered in New York (since a registration by the franchisor may have been for past sales, and then expired after a year when no longer needed).

e. Other Exemptions

New York has certain other exemptions that are of very limited relevance to restaurateurs and we therefore do not describe them in this paper other than the following: an exemption for a sale to a bank or similar types of institution;[30] an exemption by order[31] (discretionary by the Department of Law where the department finds that such action is not inconsistent with the public interest or in the protection of prospective franchisees; for example, such exemptions are often granted on a franchisor's request, with respect to international franchise sales that are made

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[28] N.Y. GBL, § 681(11).

[29] *Id.*, § 684(5).

[30] N.Y. GBL § 684(3)(b).

[31] *Id.*, §§ 684(1), 684(4).

from New York); an exemption for credit card plans;[32] a New York State "International Franchise Expo" trade show participation exemption;[33] and, a motor fuel sales exemption.[34]

New York also has a two tiered, "large franchisor" exemption, also called a "net worth" exemption.[35] The state affords this "net worth" exemption devoid of any "experiential" prerequisite on the part of the franchisor. Under the first tier of this exemption, if the franchisor either (1) has a net worth of at least $15 million or (2) has a net worth of at least $3 million and is at least 80% owned by a corporation which has a net worth of at least $15 million (where net worth is calculated according to the most recently audited financial statement), then it need not register its disclosure document with the New York franchise regulator. NY GBL Sec. 684(3)(a). Under the second tier of this exemption, if the franchisor has a net worth of at least $5 million, or has a net worth of at least $1 million and is at least 80% owned by a corporation that has a net worth of at least $5 million, then it may file an application for exemption with the New York franchise regulator (which is subject to the regulator's discretion but is typically granted). NY GBL Sec. 684(2)(a). Note, however, that the net worth exemption is only an exemption from having to obtain registration of its Franchise Disclosure Document. Under either tier of this exemption, the franchisor still needs to have a disclosure document, and provide it to the franchisee prior to the sale of the franchise, so the cost of generating the Franchise Disclosure Document itself (which can be substantial in terms of both money and time) would not be avoided.

VI. CASE SCENARIO

Many restaurateurs are completely unaware of franchise law as outlined in this paper, and may very well already be in technical breach of it. Therefore, for illustrative purposes only, we present and analyze here a hypothetical scenario in which franchise law should be considered. This is the somewhat common situation where a restaurateur seeks additional streams of revenue through spinoff licensing concepts.

a. Shared Name; Special Sauce

Mick is a former waiter at an upscale Italian restaurant, Baldassario, located in Manhattan. He is the nephew of the owner of Baldassario, Uncle Bill. Mick recently opened a casual pizzeria in a trendy area of Brooklyn.

Throughout its 40 years of operation, the Baldassario restaurant name has been associated with quality, authentic Italian food and is widely known for serving its special homemade marinara sauce, which the restaurant cans and sells to select distributors. Mick worked at Baldassario as a waiter for several years in college and has always been close with his Uncle

[32] *Id.*,§ 684(6).

[33] The exemption is derived from the New York Department of Law's discretionary exemption authority, and appears on the New York Department of Law's website together with the relevant application forms.

[34] N.Y. GBL § 681(3).

[35] *Id.*, § 684 (2).

Bill. As such, when Mick asked Uncle Bill to help build up Mick's new pizzeria business by allowing the use of the Baldassario restaurant name and special sauce, Uncle Bill was happy to help. Accordingly, Mick's new pizzeria prominently states its affiliation with the Italian restaurant on its signs, menus and marketing materials, and also advertises its use of the restaurant's special sauce on its pizzas. Grateful for the help, Mick offered to pay Uncle Bill two percent of the pizzeria's gross sales, but Uncle Bill replied, "Nah that's OK, you're family, don't worry about it."

Moreover, Uncle Bill granted Mick's pizzeria the right to sell the Baldassario restaurant's special marinara sauce, which is prominently displayed in cases and jars at the pizzeria, marked with Baldassario restaurant's trademarked logo. Under the terms of a three-sentence "distribution agreement" they both signed: (1) The pizzeria pays slightly above the wholesale price for the sauce: instead of the usual $30 per case that Baldassario charges local supermarkets and gourmet food stores, Mick's pizzeria will pay $36 per case; (2) The agreement forbids the pizzeria from selling other canned, jarred or bottled marinara sauces or otherwise competitive products; and, (3) The agreement restricts all sales of the special sauce by the pizzeria to the pizzeria's Brooklyn location.

b. Is this a Franchise?

Among the potential franchise elements in the above scenario are the following:

- The use of the restaurant's name on signage, menus and marketing materials could indicate a substantial association with the restaurant's trademark. <u>See</u> NY GBL Sec. 681(3)(b).

- While there is no initial franchise fee, ongoing royalty, or other fee that is typical of most franchise agreements, there is a fee in the form of paying more than the bona fide wholesale price for the sauce. Recall that purchases at bona fide wholesale price are expressly excluded from the definition of a franchise fee under New York's franchise law. <u>See</u> NY GBL Sec. 681(7)(a). But in this case, Mick pays a full twenty percent more than the wholesale price charged to others such as local supermarkets and gourmet food stores. That 20% difference might very well be deemed a franchise fee. <u>Id.</u>

  Note that the "franchise fee" element, combined with the "trademark license" element, are enough to trigger New York's franchise laws, rules and regulations.

- Moreover, by allowing the pizzeria to sell its bottled sauce and proscribing some (albeit not many) restrictions on those sales, one could argue that the restaurant is exercising substantial control over an aspect of the pizzeria's operation – i.e., a marketing plan. <u>See</u> NY GBL Sec. 681(3)(a). However, that argument would probably not fare as well, since there is no indication that the restaurant (or Uncle Bill, acting on its behalf) really imposes any control or oversight over the operation of the pizzeria.

If there is a "marketing plan," then that, combined with the franchise fee, would be enough to trigger New York's franchise laws, rules and regulations, without even requiring a trademark license. If there is not a "marketing plan," then the other two elements above would constitute a franchise.[36]

Therefore, it appears this scenario would most likely be a franchise. One might wonder how it could be deemed a franchise when it is a friendly agreement between family members without much formal documentation. However, this would not be considered an agreement between "affiliates" under franchise laws, as there is no relationship of common control between the two parties. Uncle Bill does not control his nephew Mick, nor are they under common control; they are independent parties. Moreover, the agreement need not be in writing in order to meet the elements of a franchise; in fact, it could be completely oral. And, as we discussed earlier, whether the parties call it a franchise or think of it as one has no bearing on whether it is one.

As a hypothetical case with limited detail, this scenario cannot be used to draw conclusions about real life cases. Real situations should be analyzed on a case by case basis in light of all details.

c. Would Any Franchise Law Exemption Apply?

One exemption to consider would be the "isolated" sale exemption described in Section V. However, in this case, it appears that the restaurant has been selling its sauce to retailers (and perhaps distributors), and intends to continue to do so. Depending on whether those other licenses are franchises in New York State, the license to Mick's pizzeria may not qualify as a single sale in New York.

Another exemption to consider would be the fractional franchise exemption described in Section V, if the sales of sauce at the pizzeria would be anticipated in good faith by the parties to be less than 20% of the pizzeria's total sales in any year. However, this exemption falls flat, because Mick's pizzeria is new. The fractional franchise exemption would require that the franchisee's business has been operated for at least the last 24 months. Therefore, the fractional franchise exemption probably could not be utilized in this scenario.

If the franchisor here (Baldassario restaurant) has a high enough net worth, it is possible it could be exempt from the need to register a franchise disclosure document, as described under the "net worth" exemption in Section V. However, even if Baldassario has a net worth of over $15 million (automatic exemption), or over $5 million (exemption subject to the New York State

[36] As an aside, although not a matter of franchise law but, rather, trademark law, if a franchisor (as licensor of a trademark or service mark) does not impose upon its licensee any standards or controls as to how the mark is used by the licensee, that franchisor's trademark (applicable to goods) or service mark (applicable to services) may be deemed abandoned as a matter of law, as it could be viewed as standing for nothing. Thus, if a restaurateur – whether it is Uncle Bill in our hypothetical case, or a real restaurateur – derives value from the quality associated with its mark, it should not license the use of its marks without imposing such standards. See Lanham Act, 15 U.S.C.A. Secs. 1051-1172 (2002); and for illustrative cases, see *Oberlin v. Marlin Am. Corp.*, 596 F.2d 1322, 1327 (7th Cir. 1979); *Haymaker Sports, Inc. v. Turian*, 581 F.2d 257 (CCPA 1978); *Westco Grp., Inc. v. K.B. & Assocs., Inc*., 128 F. Supp. 2d (N.D. Ohio 2001); *First Interstate Bankcorp. v. Stenquist*, 16 U.S.P.Q. 2d (BNA) (N.D. Cal. 1990).

regulator's discretion, after filing an application) as established by audited financial statements (unlikely for most restaurateurs), the net worth exemption would only excuse Baldassario from the need to register a franchise disclosure document. In other words, even if Baldassario's net worth is high enough to qualify for this exemption, Baldassario would still need to create a disclosure document and furnish that to Mick well before entering into the agreement with him or accepting any payment from him for the franchise, in order to comply with applicable franchise laws.

VII. WHAT ARE THE NEXT STEPS IF YOU FIND THAT YOU ARE AN ACCIDENTAL FRANCHISOR?

All hope is not lost for business operators who find themselves as accidental franchisors. In most cases, these franchisors can avoid litigation pitfalls and take the steps necessary to bring their business into compliance with state laws. However, they must take a proactive approach and carefully consider all appropriate legal strategies to address the issues at hand.

a. Anticipating Franchisee Litigation

Where litigation over inadvertent franchising happens, it is often brought by one or more unhappy counterparties who are unsatisfied with their current arrangements with a restaurateur, seek out a lawyer's assistance, discover that the existing arrangement might be considered a franchise, and then assert claims against accidental franchisors for violating state and/or federal franchise laws. To effectively defend against or avoid such actions, franchisors should first gain an understanding as to which laws were violated and whether any exemptions or defenses apply. As such, their counsel should assess all business dealings with "franchisees" to determine the full scope of potential litigation or violations: exactly what was offered, what was sold, who were the parties, what are their respective states of residence (in the case of individuals) or principal places of business (in the case of business entities), and what consideration was paid and when, among other key facts.

Once a violation is discovered, counsel should move quickly to identify all affected franchisees and gain a complete understanding of the circumstances surrounding each business relationship.[37] That analysis will play a crucial role in forming the appropriate defense strategy. For example, it is essential to know, among other factors, whether the accidental franchisor/franchisee relationship is amicable and profitable, since disgruntled and unprofitable franchisees are more likely to report violations and file lawsuits against their franchisors.[38]

Franchisors in violation of the New York Franchise Sales Act are liable to franchisees for damages, plus interest accruing at 6% per year from the date of purchase, along with reasonable attorneys' fees and court costs.[39] In addition, franchisees may seek rescission for any violation

[37]*See* Dale E. Cantone, Kim A. Lambert and Karen C. Marchiano, *So It Really is a Franchise: Bringing Non-Compliant Franchisors Into Compliance*, ABA 37th Annual Forum on Franchising W-18, at 24 (2014).

[38] *Id*.

[39] N.Y. GBL § 691(1).

deemed willful and material.[40] Personal liability may attach to individuals in certain instances, even if the "franchisor" entity is technically a business entity with limited liability protections.[41]

b. Litigation Defenses

i. Statute of limitations

Because of the harsh civil penalties imposed by New York's franchise statute, rules and regulations, accidental franchisors should contemplate all available contract defenses (e.g., lack of reliance, release, waiver or estoppel, reliance on counsel), including the three-year statute of limitations.[42] In New York, any claim asserting a violation of the state's franchise law will be time-barred if brought outside the statutory period.[43] Specifically, Section 691(4) of the New York Franchise Act provides that a private action commenced thereunder "shall not be maintained … unless brought before the expiration of three years after the Act or transaction constituting the violation." Thus, it is incumbent upon counsel to determine when the statute of limitations has been triggered for each act or transaction in question.

As noted previously, the New York Franchise Act does not mandate annual renewal of any franchisor's franchise registration if the franchisor is not continuing to offer or sell new franchises. To the contrary, a franchisor need only be registered at the time it offers or sells franchises, and not at any subsequent time when it may collect all or a portion of the franchise fee for a franchise which had been sold. Registration is granted for a one-year period, and covers any franchise sales made during that one year period. For example, if a franchisor was registered with the Attorney General through March 30, 2014; does not renew its registration; offers and sells a franchise to a New Yorker on February 1, 2014; but, as provided in the subject franchise agreement, collects a portion of its franchise fee on May 30, 2014, no violation of the Act has transpired. There is no need for a franchisor to maintain its New York franchise registration solely in order to collect franchise fees under agreements lawfully offered and entered into at times when that franchisor's registration was in effect.

In simple terms, a New York franchise registration need only be maintained until such time as a franchisor has completed offering and selling franchises in the state; under no circumstance must it be maintained merely because previously sold franchises are operating in the state. The New York Franchise Act is a pre-sale disclosure statute. As observed by the New York Supreme Court in *The Southland Corporation v. Abrams, Attorney General of New York*,[44] the New York Franchise Act ceases having any force or effect following the sale of the subject

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[40] *Id*.

[41] *Id.*, § 691(3).

[42] *Id.*, § 691(4).

[43] In *Kim v. SUK, Inc.*, No. 12-CV1557, 2013 WL 656844, 2013 U.S. Dist. LEXIS 24703 (S.D.N.Y. Feb. 22, 2013), the franchisor successfully used a statute of limitations defense to a disclosure violation under the New York Franchise Sales Act.

[44] 149 Misc. 2d 390, 560 N.Y.S.2d 253 (Sup. Ct., New York Cty., 1990).

franchise. "Existing franchisees are not within the zone of interests the statute seeks to protect," held the court in *Southland*. In short, the statute is designed to protect prospective franchisees.

ii. Rescission

Accidental franchisors should explore offering rescission as a viable option under New York law to mitigate or "purge" liability under franchise law. When the process, as set out by statute,[45] is followed correctly, offering rescission to the franchisee can serve as a useful mitigation tool that in some cases will allow accidental franchisors to avoid liability by significantly reducing the statute of limitations period. By sending franchisees written offers of rescission, franchisors can shorten the three-year statute of limitations on claims, to instead be 30 days in which franchisees can bring civil actions. The 30-day period takes effect upon the franchisee's receipt of such notice.[46] If the franchisee accepts the offer of rescission, then the franchisor must rescind the subject agreement. If the franchisee rejects the offer of rescission, then the franchisee is barred from later demanding that the contract be rescinded.

The written offer must include an agreement to refund all consideration paid for the franchise, together with interest at six percent per year from the date of payment -- *minus* the amount of income earned by the franchisee from the franchise.[47] If the franchise arrangement has been profitable up to that date, it is quite possible that, after doing the math, it will turn out that no actual refund of money would be owed by the franchisor to the franchisee if the franchisee chose to accept rescission of the contract. Additionally, the offer must be conditioned upon the franchisee returning all items received by the franchisee for the consideration paid, excluding all items sold. The offer extinguishes any right the franchisee may have to bring an action against the franchisor for possible violations of the New York State Franchise Sales Act, whether the offer is accepted or rejected. Thus, any franchisee in receipt of the written offer cannot maintain a lawsuit regardless of whether they fail to either accept or reject the offer. Lastly, the New York State Attorney General's Office (as mentioned above, also known as the Department of Law) must approve the form of the written rescission offer in order for it to be effective.[48] This entails a process of communication with the Department of Law prior to making the rescission offer, to obtain their approval of the form of rescission offer letter. Sample forms of "Rescission Offer" letters can be found on the New York State Attorney General's website.[49]

iii. Anticipating New York State enforcement actions

The Department of Law has far-reaching power to investigate and pursue enforcement actions against franchisors.[50] Actions brought by the Department of Law could result in civil

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[45] N.Y. GBL § 691(2).

[46] *Id.*

[47] *Id.*

[48] *Id.*

[49] https://ag.ny.gov/franchisors-franchisees#Rescission

[50] N.Y. GBL § 688.

fines, payment of restitution, criminal charges, and temporary or permanent bars on franchisors from selling franchises in the state.[51] There is no process for administrative hearings in the New York statute. While the Department of Law has broad investigatory authority, it must file a lawsuit to recover restitution.

c. Self-Disclosure

When faced with the possibility of a New York State enforcement action, accidental franchisors should take into account the benefits of self-reporting to the Department of Law, especially when the violation is immaterial and readily can be remediated. While a technical breach of New York's franchise registration laws might cause no demonstrable harm to the franchisee in some cases, the Department of Law is in a unique position to easily spot such violations, since its agencies maintain all franchise registration records (or failure to so register). Thus, accidental franchise cases where the arrangement is in public view are likely to be low-hanging fruit for the state regulator to prosecute if not self-reported beforehand. For that reason, assuming no exceptions or defenses apply, accidental franchisors should promptly report such violations. Furthermore, notifying franchisees, and, by extension, New York State, through a formal rescission offer process could earn franchisors extra "brownie points" with the regulator. Franchisors are advised to work with state examiners professionally and courteously and respond swiftly to all related document requests. Naturally, a regulator will be more inclined to issue lower fines and less severe penalties to those franchisors viewed as cooperative and seeking to resolve the legal violations in good faith.[52] For example, it is not atypical for the Franchise Section of the Department of Law to be willing to accept a sworn "Assurance of Discontinuance" from an errant franchisor in lieu of commencing a statutory proceeding for violations of the New York Franchise Sales Act based on the errant conduct. Under an Assurance of Discontinuance, an errant franchisor will typically pay an agreed amount of penalties and investigative costs to the State of New York, offer rescission to franchisees, and take other actions prescribed by the Department of Law to help ensure that a violation does not recur.

On the other hand, unresponsive or obstructive franchisors, or franchisors who knowingly avoid registering their franchise arrangements for an extended period could face stiffer penalties, even where the enforcement process is eventually brought about through self-disclosure.

d. Additional Factors to Consider

In addition to evaluating a franchisor's candor throughout the self-reporting process, state examiners will typically inquire into the following factors, among others, when determining enforcement-related penalties:

- Litigation and violations associated with the franchisor and its principals;

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[51] N.Y. GBL § 689(1), 689(4), 692(1).

[52] *See* Anthony Marks, Dawn Newton and Gerald Wells, *"Oh No, They Did What?! What Do We Do Now?"* ABA 41st Annual Forum on Franchising W-16, at 18-19 (2018).

- The franchisor's proposed remediation plan;
- Number of franchises sold within the state;
- Actions taken by other states (if any other states' franchise or other laws are also involved);
- When and how the violation occurred;
- Whether the franchisor believed in good faith that the conduct was legal (as opposed to an intentional violation);
- Amount of fees paid by franchisees;
- The size of franchisees' total investments;
- Whether the franchisor relied on incorrect legal advice; and
- The total number of franchises sold in other states.[53]

VIII. CONCLUSION

A New York restaurateur considering any kind of license or distribution arrangement involving its brand should be aware that in many scenarios it is not possible to avoid the franchise laws. In other cases, one can avoid triggering franchising with careful planning and the aid of legal counsel well versed in franchise law. If a restaurateur happens to cross the line into franchising without realizing it, it may be far more costly to manage the violation of the franchise laws than it would have been to comply with the legal requirements of those laws in the first place. Before a restaurateur takes steps to avoid franchising, it should bear in mind the fact that many companies have been very successful expanding their businesses through franchising, notwithstanding the existence of extensive regulation.

Our aim here is to provide an overview of the key franchise compliance considerations a restaurateur in New York faces. There are, of course, additional steps, nuances, and details on compliance which will depend on the situation. The Hospitality Law Committee of the New York City Bar Association includes among its ranks experts in franchise law who can refer restaurateurs to appropriate legal counsel in this area if needed.

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[53] *See* Cantone, et al., *supra* n. 37, at 25.

APPENDIX I

New York General Business Law, Section 681

“Franchise” means a contract or agreement, either expressed or implied, whether oral or written, between two or more persons by which:

(a) A franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor, and the franchisee is required to pay, directly or indirectly, a franchise fee, or

(b) A franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services substantially associated with the franchisor’s trademark, service mark, trade name, logotype, advertising, or other commercial symbol designating the franchisor or its affiliate, and the franchisee is required to pay, directly or indirectly, a franchisee fee.