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**KEEPING YOUR DISTRIBUTORSHIP/DEALERSHIP OFFERING
FROM BEING A FRANCHISE OR BUSINESS OPPORTUNITY
-- THE "DON'TS"**

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KEEPING YOUR DISTRIBUTORSHIP/DEALERSHIP OFFERING FROM BEING A FRANCHISE OR BUSINESS OPPORTUNITY—THE “DON'TS”

A manufacturer of a product or a seller of distributorships/dealerships must make sure, from the inception of its program through sale and performance, that its program does not inadvertently become the sale of an unregistered and undisclosed franchise or business opportunity. Merely saying that you are not a franchise or business opportunity and calling your offering something else is of no help. To do this properly and effectively, you must know the elements of a franchise and of a business opportunity and avoid having these elements in your distributorship/dealership or other product sales program. Here's a brief description of the 3 "don'ts" to avoid the franchise laws and the 5 "don'ts" to avoid the business opportunity laws.

AVOIDING FEDERAL AND STATE FRANCHISE LAWS

Under the FTC Franchise Rule, a "franchise" consists of three elements: (1) the license of a trade name or substantial association with the seller's trade name; (2) the payment of \$500 or more on or before the first 6 months of operation (exclusive of inventory purchases); and (3) significant assistance to, or significant control over, the buyer's method of operation. If any one of these three elements is missing, the program is not a franchise under the FTC Franchise Rule. You will also need to check the definition of a franchise under the laws of the states in which you are located and in which your distributors or direct purchasers are located, as state definitions vary and may be broader than the definition under the FTC Franchise Rule.

1. Don't Allow Buyers to Use Your Name

Your purchase order, distributorship/dealer contract or other agreement should specifically prohibit the buyer from using your trade name in the buyer's business, in the buyer's business name or in any other matter, except that the buyer, in his or her stationery, business cards, etc., can state that he or she is an authorized distributor/dealer of your products or services. In addition, if you grant exclusive rights to your distributors/dealers which prohibit your distributors/dealers from

selling competing or other products, make sure your distributors/dealers are not "substantially associated" with your trade name or trademark. You may want to discuss this issue with an attorney.

2. Don't Charge Fees Beyond Inventory Sales

The FTC Franchise Rule includes within the definition of a "franchise fee," any payments by a buyer to the seller or to the seller's affiliates, except the purchase of a reasonable amount of initial and ongoing inventory at bona fide wholesale prices. This includes not only the traditional initial franchise fee, but also payments for equipment, product displays, sales kits, advertising, etc. You can charge for these items by having the buyer sign a non-negotiable promissory note as long as the note is not payable until at least month 7 after the buyer begins operating the business.

3. Don't Significantly Control the Buyer or Provide Significant Assistance

If you are a product seller -- just be a product seller, nothing more. Don't require, or even provide, significant assistance particularly marketing assistance to your buyers. Training in the use, maintenance and repair of the products you sell to the buyer is acceptable. Don't significantly control your buyers. You should discuss with an attorney the degrees of control (for example, territorial or customer restrictions) and the degree of assistance you can provide, you need or want to provide, in connection with your program without crossing over the franchise line.

AVOIDING THE FTC BUSINESS OPPORTUNITY RULE

The definition of a "business opportunity" under the FTC Business Opportunity Rule involves a commercial arrangement that has the following 3 required elements:

(a) The seller solicits a prospective purchaser to enter into a new business (one in which the prospective purchaser is not currently engaged or a new line or type of business).

(b) The purchaser makes a "required payment," that is, all consideration paid by the purchaser to the seller or an affiliate as a condition to obtaining or commencing the operation of the business opportunity except for payments for the purchase of a reasonable amount of inventory at bona fide wholesale prices for resale or lease.

(c) The seller represents that the seller or a designated person (such as a locator or lead generating company) will provide any of 3 types of assistance: (i) providing locations for the purchaser's use or operation of equipment, displays, vending machines, or similar devices that the Purchaser controls; (ii) providing outlets, accounts or customers to the purchaser; or (iii) buying back any of the goods or services that the purchaser makes, including providing payment for such services such as stuffing elements from home or jewelry assembly.

1. Don't Solicit People to Enter into a New Business

Do not have a business arrangement where you solicit a prospective purchaser to enter into a new business (one in which the prospective purchaser is not currently engaged or a new line or type of business).

2. Don't Charge Anything Except for the Sale of Inventory

Don not charge a purchaser a "required payment," that is, all consideration paid by the purchaser to the seller or an affiliate as a condition to obtaining or commencing the operation of the business except for payments for the purchase of a reasonable amount of inventory at bona fide wholesale prices for resale or lease.

3. Don't Provide Certain Types of Assistance

You a designated person (such as a locator or lead generating company) should not provide any of 3 types of assistance: (i) providing locations for the purchaser's use or operation of equipment, displays, vending machines, or similar devices that the purchaser controls; (ii) providing outlets, accounts or customers to the purchaser; or (iii) buying back any of the goods or services that the purchaser makes.

AVOIDING STATE BUSINESS OPPORTUNITY LAWS

There are 25 states that regulate this type of business opportunity and several other types of business opportunities. The specific types of business opportunities that are regulated vary from state to state. Generally, if you sell or lease a product or service which costs \$500 or more to enable the buyer to get into business, you may be considered a business opportunity seller, if you do one of several additional things for your buyer. It is these additional "things" that you must avoid.

1. Don't Provide Site Location Assistance

If you sell vending machines, racks, display cases or other similar devices, or amusement or other coin-operated machines, do not provide, directly or indirectly, any site location assistance to the buyer. You cannot even give them the name of a site locator company or mention possible locations for the product. Let the buyers find their own locations or a site locator.

2. Don't "Buy Back"

The business opportunity laws regulate sellers who "buy back" what the buyer makes, grows, breeds, assembles, fabricates, etc. (for example, worm farms and chinchilla ranches) from that which the seller sells to the buyer. If your program is similar to this, you are a business opportunity seller and you also have to purchase a surety bond in order to register as a business opportunity states in those states regulating business opportunity sellers. A warranty for defective goods is acceptable.

3. Don't "Guaranty" the Buyer's Investment.

Don't include in your program a "guaranty" in writing that the buyer will derive income from the products or services purchased from you which exceeds the price paid or that the seller will refund all or part of the price paid or will repurchase any of the products supplied by the seller, if the purchaser is unsatisfied with the business opportunity. Stand behind the quality of your products or services, but don't represent to the buyers that they can make money. If you make such a "guaranty," you may be a business opportunity seller and you also may to purchase a surety bond in order to register as a business opportunity states in those states regulating business opportunity sellers.

4. Don't Provide a Sales or Marketing Program

Remember, you just sell products. Leave the buyers on their own as to what they are going to do with the products or services you sell to them. If you provide the buyers with a sales or marketing program, you may be considered a business opportunity seller. There is a great deal of ambiguity from state to state as to what constitutes a sales or marketing program. For example, under the Florida regulations, a "sales program or marketing program" means:

(a) A written or oral procedure or plan provided by the seller to a purchaser of a business opportunity concerning products, equipment, supplies, services or training that the seller represents will be provided on how to sell or market the product or service; or

(b) Where the seller provides to the purchaser the following devices, techniques, training or materials which will assist the purchaser in deriving income from the business opportunity;

(1) Sales or display equipment or merchandising devices;

(2) Specific sales or marketing techniques; or

(3) Sales, marketing or advertising materials which are intended for use

by the purchaser to influence a consumer to purchase a product or service.

This issue will need to be discussed with an attorney.

5. Don't Represent That There is a Market For Your Goods or Services.

This one is a real "Catch-22." Fortunately, only a handful of states have this requirement. The simple answer is to stay out of these states, such as California and Indiana. Your marketing materials must be examined carefully by you and your attorney. You may want to consider getting an opinion from the state that you are not a business opportunity seller for before selling or advertising in a state that regulates this type of business opportunity.

As you can see, product manufacturers and sellers of distributorships/dealerships walk a thin tightrope above the lions and tigers of franchise and business opportunity laws. You need to have an attorney knowledgeable in these areas of law review all of your contracts, marketing materials,

telemarketing scripts, etc., to make sure that you and your employees and salespersons, neither orally nor in writing, "do" when you and they are supposed to "don't."

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