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What Is Franchising? A Look At New York's Broad Definition

By **David J. Kaufmann**

The New York Franchise Act is perhaps the nation's toughest franchise law—and one seminal reason why 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.[1]

This definition is in sharp contrast to that utilized by every other jurisdiction regulating the sale of franchises, where all three elements set forth above—"trademark," "marketing plan" and "franchise fee"—must be present for a franchise to exist. In New York, as noted, either of the first two elements combined with the franchise fee component will suffice. This broadened definition of the term "franchise" thus covers many species of licenses, distributorships and other commercial relationships not previously concerned with franchise regulation. For example, those companies engaged in the business of granting "rack job" distributorships—that is, conferring on individuals (in return for a fee) the right to establish and/or maintain and restock product vending outlets at retail locations, and to earn commissions based on sales at those locations—may be deemed to be "franchisors" in New York.

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 required to comply with the New York Franchise Act's requirements.

Making Determination

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,[2] which make clear that:

> 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.[3]

Importantly, 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."[4]

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 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."[5]

Further, 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 franchise agreement itself, 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.[6]

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Convenience/Gas

The issue has arisen as to whether a franchise that embraces a one-stop convenience store coupled with a gasoline station falls within the purview of the New York Franchise » Page 9

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Act. Gasoline station franchises are wholly exempt from the New York Franchise Act's coverage, while convenience store franchises are clearly embraced by the New York Franchise Act (unless the franchisor can avail itself of another statutory exemption.)

In an Opinion of the Attorney General dated on Oct. 19, 1993 (Formal Opinion No. 93-F4) (responding to a narrower inquiry as to whether such a joint franchise fell within the meaning of "chain store" for purposes of the Cigarette Marketing Standards Act [Tax Law, Article 20-A]), the Attorney General opined that, in fact, such a joint convenience store/gasoline station franchise falls within the scope of the New York Franchise Act.

Observed the Attorney General:

> The definition of "franchise" as set forth in GBL Article 33 is broadly stated and sufficiently broad to include within its ambit a franchise relating both to the retail sale of motor fuel and operation of a convenience store. Indeed, as the entity charged with administration of Article 33, this office has construed the provisions of Article 33 to apply to franchises for one-stop convenience stores and gas stations. Mixed-use gas stations register with the Department's Bureau of Investor Protection and Securities pursuant to the provisions of Article 33... Since the Legislature in adopting GBL Article 33 made specific findings about the harms of the unregulated sale of franchises and declared its intent to protect prospective franchisees (statutory citation omitted), it is appropriate to construe narrowly the exclusion set forth in GBL §681[3][b] to apply only to franchises for gas stations alone and not to mixed-use gas stations.

This opinion has significant impact in the gasoline service station arena. Many gasoline distributors find it far more profitable to franchise combination gas station/convenience store units than gas station/repair shop units. So it is that the above-referenced opinion afforded gasoline service station dealers protections under the New York Franchise Act which they previously did not enjoy.

1. New York Franchise Act, §681(3).
2. 13 NYCRR Chapter VII, §§200.1 et seq.
3. Id. at §200.1(a).
4. New York Franchise Act, §681(7)(a).
5. Id. at §200.1(b).
6. New York Franchise Act, §682.