Franchising, Licensing and Certification Programs:
What's The Difference?

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A trademark or service mark is, primarily, an indication of the source of the goods or services identified by the mark. The mark indicates to the public that a product or service will have the quality that they have come to expect from the source indicated by the mark—if a customer buys one can of X brand soup it should expect the next can to be of equal quality. Trademark quality control is not so much insuring high quality. Rather, it should insure consistency so that consumers know what to expect.

A "license" is merely an agreement that gives one person the right to use something that belongs to someone else. Licensing a third party to use a trademark or service mark carries the requirement that the licensor maintain control over the quality of the licensee's goods or services to ensure that the public is not deceived by putting a mark on something that is at variance with the quality the brand has come to represent. If the owner of a mark allows the mark to be used for something without such quality control, the trademark or service mark owner can lose its right to the mark. The owner must not only maintain quality control over licensees it authorizes to use its mark but it must "police" its mark to stop others from using the mark without permission since such use would deceive the public about source and quality. If the mark no longer represents the quality or the source of goods or services, the owner of the mark will not be able to defend the mark against unauthorized use—infringement—and the mark may lose its legal protections.

The licensing of a mark can be an end in itself since payment for the right to use a mark can be substantial, depending on the strength of the mark. Disney, for example, licenses clothing manufacturers to use trademarked Disney characters, as well as copyrighted character artwork, on their products or toy manufacturers to provide toy representations of those characters. Disney maintains quality control to insure its valuable goodwill is not damaged. It does not, however, tell the manufacturer how to run its business or provide substantial help in marketing the items produced. The products and packaging show that the copyrights and trademarks on the characters belong to Disney. The manufacturer does not hold itself out as Disney but, rather, it does business under its own name, such as XYZ Toys. Disney probably has some sort of performance requirements concerning the volume of items that must be sold in order to keep the license and requires a payment, often based on sales volume, for the right to make and sell the licensed items.

There are some businesses that test, inspect or qualify the goods or services of others and provide them with some sort of certification or rating if the goods or services satisfy certain requirements. Indeed, the U.S. Patent and Trademark Office classifies certain marks as "certification marks" for this purpose, such as the Underwriters Laboratories "UL" mark, the

Good Housekeeping Seal, the Union Label and so forth. Those granting the use of their certification marks usually charge a fee for the testing and certification. The owner of a certification mark cannot award the certification mark to its own goods or services or use the mark to identify its own business activities, i.e. The UL Company.

A different kind of certification can be granted by the owner of a regular trademark or service mark. For example, it can use its mark to certify that someone it has trained has achieved proficiency in the skills taught. The owner of the mark may allow the person so certified to use the mark to identify the services for which the user was certified but not to identify the person's business. For example, a fitness business can certify that its, or a third party's, instructors have achieved a certain level of competence in one or more training techniques and can authorize them to use the grantor's mark to indicate the specific classes taught utilizing the grantor's techniques. However, the person certified cannot hold themselves out as doing business under the grantor's mark, unless, of course, he or she has been granted that right separately, such as by a franchise agreement.

Since a mark and a fee will be involved in most licensing arrangements, the degree of control that a licensor wants to have over the activities of the licensee must be examined in order to determine the legal classification of the arrangement. If the only requirements put into a licensing agreement are designed to protect the mark from improper use and ensure proper payment to the licensor, such as terms relating to quality control, reporting and audit rights, and the licensor does not otherwise get involved in how the licensee runs its business, the arrangement will be not be a franchise. If the grantor of a certification merely indicates that goods satisfy certain quality standards or that the provider of services has attained a certain level of proficiency in providing those services, the certification, without more, will engender no separate legal issues. However, if either arrangement contains assistance or control over the licensee's method of doing business, it may well end up to be a franchise.

In the United States, the issue of what constitutes a franchise under the law is complicated by the variety of definitions of the word "franchise" under federal and state law. The Federal Trade Commission ("FTC") has issued a trade regulation rule specifying that a Franchise Disclosure Document ("FDD") containing 23 categories of disclosure be presented to a prospective franchisee anywhere in the U.S. at least 14 calendar days before the franchisee signs any binding agreement or pays any money or other consideration to the franchisor, as more fully discussed in the article "Franchising a Business" on this website. In addition, all contracts the franchisee may be required to sign must be provided as part of the FDD. The FTC rule defines the non-trademark, non-fee element of the franchise definition as where the contract specifies, or the franchisor promises or represents, orally or in writing, that the franchisor will exert, or has the authority to exert, a significant degree of control over the franchisee's method of operation or provides significant assistance to the franchisee. The control or assistance must pertain to the franchisee's entire operation, not merely one aspect, such as where the franchisor trains the franchisee in the operation of a trademarked machine for use in a business but leaves the operational decisions of the business itself to the operator.

Three definitions of "franchise" can be found under state law. The most common is where, in addition to the trademark license and fee component, the franchisor provides, suggests or makes available a "marketing plan or system" for the franchisee to use. ("System" refers to the method of operation of the business, not just to a method of marketing.) Needless to say, "marketing plan or system" is a rather imprecise standard that has largely been left to regulatory agencies and the courts to define. Clearly, teaching someone how to run a business and requiring them to run it the way they were taught would be a marketing plan or system—business format franchising. However, not all agreements are that clear. Often it is necessary to look at the services provided by the licensor and the requirements placed on the licensee in order to determine whether they add up to a "marketing plan or system". Some of the things that a court or administrative agency may look at in determining whether a franchise exists are: whether the licensor provides training, ongoing advice or suggestions; whether there are marketing or business restrictions; whether the licensee is required to prepare, carry or sell the licensor's products or services; the imposition of price restrictions or requirements; the use of specified equipment or sales or production techniques; the required or suggested use of specified advertising and promotional materials or systems; a requirement that advertising be preapproved; the grant of an exclusive or protected area or area of primary responsibility; requiring participation in cooperative advertising programs; requiring financial reporting or the use of specified bookkeeping systems; the limitation or prohibition on the sale of competing goods; requiring location approval; requiring approval the format, appearance and/or layout of the licensee's place of business; limiting the sources of supply that a licensee may use; specifying the ingredients and/or manner of preparation of the items sold; requiring the use of prescribed uniforms, signs, color schemes or the like; dictating the licensee's hours of operation; dictating how or what services may be provided; and so on. Also, considered by courts and administrative agencies is whether the public is led to believe that each enterprise is under the control or guidance of the trademark licensor and/or that a common experience can be expected. While no one characteristic may dictate the existence of the "marketing plan or system", the existence of several of those features may be determinative. A "marketing plan or system" may be found even if the assistance of, and requirements specified by, the licensor are merely suggested or made available but are not mandatory and even if they are never actually used by the putative franchisee.

A few states, instead of using the "marketing plan or system" component in addition to the trademark and payment elements, find an arrangement to be a franchise if there is a "community of interest" between the grantor and the grantee of the rights in question in the marketing of goods or services. This interest is usually defined as a continuing financial interest between the parties, such as where the grantor is paid based on the sales of the grantee, as by receiving a percentage of the sales of the grantee. Courts have sometimes used some of the same criteria as are used in determining the “marketing plan or system” element under the “community of interest” test in order to decide whether a franchise exists. Clearly, “community of interest” casts a wider net than “marketing plan or system” since most distributorships, dealerships and franchises satisfy that term. At least one state uses the “marketing plan or system” definition to determine a “franchise” under its registration law and the “community of interest” definition under its dealership law. Dealership laws usually apply to franchises as well as other relationships and limit a grantor/franchisor’s rights in matters such as renewal and termination of the relationship.

New York is unique in defining “franchise” by using an either/or approach. Its statute says a franchise is “marketing plan or system” plus a fee or, alternatively, using the franchisor’s trademark in offering, selling or distributing goods or services plus a fee. This would make any traditional trademark licensing arrangement a franchise, although some New York courts that have reviewed franchise controversies seem to have added both alternatives together to some degree when appropriate.

If a relationship is found to be a franchise, compliance with the disclosure requirements of the FTC rule must be accomplished, state registration or filing must be done where required and, where applicable, state relationship laws will apply, as discussed in “Franchising a Business”. Compliance with these requirement and the costs related to that compliance, plus an unfounded fear of litigation are usually what motivate licensors to attempt to avoid being franchises. The first thing to do is to determine whether an exemption or exclusion from the application of any applicable franchise law is available. The problem is that exemptions and exclusions are not uniform among the FTC rule and the various state laws. Merely because a program may be exempt under the FTC rule or one or more of the state laws, it may not be exempt under the laws of another state or the FTC rule. As such, if multi-state growth is foreseen, compliance with the FTC rule and applicable state law is the best way to go.

When a trademark license or certification program cross the hard-to-define line into a franchise and there is no compliance with the franchise laws, troubles can quickly follow . If a licensee or certified person or business operates in a manner that is substantially associated with a licensed mark and a fee is paid to the licensor, or to the grantor of a certification, two of the three elements of the franchise definition—forget about New York for the moment—are satisfied. The relationship then must then be tested under the “marketing plan or system” or “community of interest” standards of the applicable state franchise laws and the “significant control or assistance” component under the FTC rule.

An example of line drawing exists in the approach of two dance-based fitness programs, Zumba and Jazzercise. Zumba maintains it is not a franchise since, while it allows local Zumba programs to use its name and payment is made to Zumba for its various levels of training, it takes the position that it does not have sufficient control over, or provide significant assistance to, its operators to qualify as a franchise. Its local providers take courses from Zumba, for which they pay, to achieve various licenses and can also join a network of Zumba instructors for added benefits for a monthly fee. The instructors must renew their licenses fairly frequently to maintain their right to teach and use the Zumba name. Jazzercise structures its program with more controls and requirements, acknowledges it is a franchise, and it complies with the federal and state franchise rules.

Another landmine: Sometimes a trademark license or a certification program, especially one with a shorter term, is amended upon renewal to add requirements, controls, benefits, assistance, etc. so that over time, perhaps after several modifying renewals, it is no longer just a trademark license or certification program but crosses the line into franchise-land.

The ultimate determination of whether a program is a franchise is often made in the context of litigation when a terminated licensee brings suit claiming it was sold an unregistered franchise or a competitor "drops a dime" on the grantor to a state enforcement agency, with all of the resulting penalties, time and costs those actions entail. The FTC staff and many state enforcement agencies will, upon request, provide formal or informal opinions about whether an existing or planned program is a franchise. However, often people who maintain that their program is not a franchise do not want to request such an opinion since if the opinion finds the program to be a franchise, as they often do, the program cannot go on maintaining that it is not a franchise.

The bottom line is that if there is a business program involving the license of a trademark and a payment, plus a continuing relationship involving control, advice, assistance, limits, and/or benefits, a careful analysis is needed to try to determine whether the program constitutes a franchise. Lawyers often can only give a "definite maybe" answer since a program in the gray area can come out either way in court, arbitration or an administrative context. If the licensor of trademark rights wants to control aspects of the business using its mark, over and above the minimum required for trademark protection, it would be much less expensive to just comply with the applicable franchise law requirements than to defend a lawsuit or an administrative action alleging failure to comply with the franchise laws.

In closing, an example and a question: Assume that the developer of a trademarked housecleaning program will, for a fee, teach prospective entrepreneurs how to implement the developer's system and, upon the satisfactory completion of the program, the developer will certify that the business owner is an "XYZ Cleaning Pro". The business owner is allowed to use the developer's trademark to identify the business. The developer wants to protect the goodwill of its mark so it specifies that the licensee cannot deviate from the cleaning process dictated by the grantor, the licensee can only use advertising approved by the grantor, it cannot operate outside of a specified area, it cannot use anyone else's products in certain parts of the cleaning process, its employees must wear logoed T-shirts while working, the vehicles used must be kept in a presentable condition and have the licensed mark on the doors, the owner must pay a percentage of their sales to the licensor, the licensee can call the licensor for advice about any problems that come up, etc. We know by now that all of this will amount to a franchise. However, to avoid being a franchise, which of the foregoing requirements should the licensor eliminate to remove it from that classification? Answer: Just about all of them. If eliminating the requirements makes the program that the licensor intended unworkable, it should acknowledge that it has a franchise and comply with the law. It will be less expensive, and involve a lot less stress, in the long run.