FEBRUARY 8, 2012

Could Your Nonprofit Chapter Network Be a Franchise System?

Charities have many legal issues on their radars, but franchise law typically isn't one of them. Consequently, a Wisconsin case applying franchise law to a nonprofit surprised many in the sector. Should you worry?

As described in the opinion, the local Girl Scouts chapter in Manitou, Wisconsin, like more than 300 other local Girl Scouts "councils," held a license from the national 501(c)(3) organization to sell Girl Scouts cookies and other merchandise. This naturally brought significant revenue to the chapter. When the national organization attempted to consolidate the chapter with other local councils, effectively revoking its license as a separate council, the chapter sued, claiming that it was a "dealer" (i.e., a franchisee) under the Wisconsin Fair Dealership Law and that its franchise could not be terminated without good cause, regardless of what any contract with the national group provided. The appellate court agreed, at one point comparing the Girl Scouts to Dunkin' Donuts, and the national Girl Scouts' effort to consolidate the chapter was stopped.

How important is this case to other charity networks with a less commercial hue? It's not clear. While the cookie sales are definitely a distinguishing factor, it's not that hard to fall under the definition of a franchise under the laws of many states (see, for example, the California Franchise Relations Act). It typically involves a three-part test, although statutes do contain exceptions:

- The putative franchisor (the national organization) grants the chapter a right to offer or sell goods or services to the public under a marketing plan;
- The marketing plan is substantially associated with the franchisor's mark; and
- The franchisor charges a fee for using its mark.

For example, a charity that licenses an educational program to local chapters and receives a percentage of resulting tuition in return might very well meet all three prongs. (Of course, the details of this test and how they're applied vary from state to state—e.g., New York requires only two of these prongs—so it's important to consult local counsel.)

The results of an "accidental franchise" can be dire—disclosure and registration requirements may apply, and franchisee protections may limit the parent's ability to enforce its affiliation agreement if the chapter goes rogue. Of course, the franchise laws were intended to protect the public from unscrupulous

RELATED CATEGORIES

- Nonprofit Network Affiliations

AUTHOR

Steven R. Chiodini
Of Counsel

ABOUT OUR BLOG

Nonprofit Law Matters looks at legal issues in the nonprofit and tax-exempt organizations world. Written by the attorneys and paralegals of Adler & Colvin, it provides updates and analysis regarding philanthropy, charity, and other exempt organization issues.

EDITORS

Eric K. Gorovitz
Principal

franchisors, and most parent-chapter affiliations in the charitable sector probably don't trigger this sort of concern. But there is unlikely to be any case law or regulatory guidance to give much comfort on this point.

Fortunately, an accidental franchise can usually be avoided, by structuring the relationship to fail at least *one* prong. The first prong—selling goods/services to the public—often is inapplicable to nonprofit parent-chapter affiliations, although offering goods or services to the public might technically be enough. (Note, however, that the federal Franchise Rule, enforced by the Federal Trade Commission, does not apply to relationships unless they are entered into with the expectation of profit. See FTC staff opinions on this matter here and here.) Where the first prong is met, the second—using the parent's brand—will usually be met too. In that case, the third prong can be avoided by charging no fee to chapters, or working with counsel to structure the fee so that it doesn't resemble a typical franchise fee.

So, in the end, even though your charity network may not look much like Dunkin' Donuts, it may still be wise to consider precautions to avoid franchise hang-ups.

Adler & Colvin | 135 Main Street | 20th Floor | San Francisco, CA 94105 | (415) 421-7555 www.adlercolvin.com