Franchise Agreements 2007: What to Expect and What to Avoid

by Mitch Miller, J.D., M.B.A.

Attaining fair franchising relationships has never been more threatened by the power and skill of highly-sophisticated franchise companies and their legal teams.

The playing field is anything but equal due to franchisee demand combined with franchisors' enormous resources that clearly intimidate most reasonable hotel owners.

However, favorable dispute resolutions can sometimes be realized through negotiation, administrative processes, and court decisions.

This year AAHOA updated its *12 Points of Fair Franchising.* Clearly, AAHOA's advocacy is essential. This article discusses the 12 Points and offers tips for hotel owners when navigating the franchise relationship.

Point 1: Early Termination and Liquidated Damages

Most franchisors can terminate a franchisee following a second unsatisfactory QA score in a 12-month period. Often, the violations cited in the second inspection had nothing to do with the first violations. The result can be termination without notice and the right to cure. This sometimes occurs, even though generally a franchise cannot be terminated without adequate notice, and the right to cure the cited default. This may be true even with a history of repeated defaults.

Notify counsel before getting a notice of termination. Franchisors have some form of review procedure. Further, by using your counsel to present your situation before you end up being terminated will likely lead to a more favorable resolution. The cost is likely to be far less than the costs resulting from termination.

Point 2: Impact/Encroachment/Cross Brand Protection

The best protection can only be obtained during the negotiation of the contract. The franchisee needs to understand what is possible. Keep in mind that the more established and powerful franchisors will be less willing to give extensive, if any, area of protection (AOP). Is it worth it or should I consider more accommodating franchisors? Remember, when negotiating AOP provisions don't forget other flags licensed by the franchisor, as well as future acquired or developed flags.

Points 3, 8 and 9: Minimum Performance and Quality Guarantees; Dispute Resolution, Venue and Choice of Law Clauses

If litigation with a franchisor ensues, both sides typically claim that the other breached the agreement, failing to perform as promised. Consider preempting the franchisor from filing outside of California. Although California law states that venue shall be in California regardless of the contract, franchisors often ignore this and then the franchisee has to fight to get the venue returned to California. This can be costly and not always successful.

Point 4: Quality Assurance Inspections/Guest Surveys

Don't take matters into your own hands, even if a competitor submits a phony guest survey (true story), and the franchisor ignores your claim of unfair practices and issues a failing QA for noncompliant guest survey scores. Submitting your own forged guest surveys to counteract the averages may likely lead to termination of the franchise, with only the realistic hope of negotiating reduced liquidated damages.

Point 5: Vendor Exclusivity

A franchisor mandated certain case goods, and then issued a failing QA because of the scratches on the "scratchproof" end tables, and dings in the mandated desk chair, created by the banging from the mandated desk. Unbelievable but true! The franchisor wanted to terminate the franchisee but hoped for the full amount of liquidated damages. A negotiated exit was achieved. Had the franchisee engaged counsel early on in the process, I think the license could have been sustained.

Points 6 and 10: Disclosure and Accountability; Franchise Sales Ethics and Practices

Review the UFOC for information regarding franchisor policies and ask the franchise sales people about the franchisor's practices. Unless addressed during negotiations, there is little you can do after the fact. Communicate the process by e-mail to create a written record. This will be useful in litigation even if the franchisor seeks to exclude the negotiations as superseded by the terms of the signed agreement.

Point 7: Maintaining Relationships with Franchisees

"Amenity creep" has become increasingly problematic, often resulting in a brand positioning change that negatively impacts a franchisee's revenue. The implied covenant of good faith and fair dealing may provide protection. However, some franchise agreements have the franchisee waive the implied covenant's application to the specific contract. Although generally this is unenforceable as against public policy, some franchisors now use language eliminating any reasonable expectations regarding such matters. By eliminating expectations, franchisors seek to deny protection from the implied covenant of good faith and fair dealing. This has not yet been tested.

Points 11 and 12: Transferability and Sale of Franchise System Hotel Brand(s)

To the extent you are an experienced hotelier, you may be able to persuade the franchisor to accept a corporation or LLC as the franchisee, without individual guarantees. Try! It creates enormous leverage if the relationship does not go well. Further, you will insulate your personal assets from exposure to potential damages.

CONCLUSION

There is no clear path to success in dealing with franchisors. You will pay over a million dollars to a franchisor during the term of the license. Without professional counsel you cannot evaluate the full risk of the relationship, nor optimally assert the little leverage you have in the relationship. It can make a huge difference, but only if you are proactive, educated and well advised.

Mr. Miller will be speaking on this subject, along with co-presenter Attorney Robert Zarco, during the California Lodging Expo® and Conference, Tuesday, November 6th, at the Oakland Marriott City Center.

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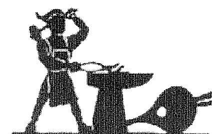

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