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November, 2005



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Franchisees Do Have Rights

Hotel owners know the relationship between franchisors and franchisees is not one of equals, either at the formation stage of the relationship or during the tenure of the contract. Despite the disparate powers of franchisors and franchisees, franchisees can exert their legal rights and employ a number of strategies to enhance and empower their abilities to optimize what can sometimes be an inherently challenging situation.

During what should be the courtship phase, many franchisors often manifest a take-it-or-leave-it attitude toward a prospective franchisee; yet, the franchisor often secures the contract anyway. Why? Mostly, it's a prospect's need for the flag and its associated benefits, real or perceived.

Admittedly, the franchise laws of many states leave franchisors little latitude to modify franchise terms during negotiations. Federal law and the laws of each state require a franchisor to file and deliver to a prospect a Uniform Franchise Offering Circular (UFOC), a document intended to provide the disclosure of all material facts, terms and conditions that enable a prospect to make an informed decision when selecting a franchise. The laws of many states require that a franchisor amend the UFOC or otherwise disclose certain accommodations extended to a franchisee during a franchise agreement negotiation. Since the UFOC includes the franchise agreement form, full disclosure would logically require that franchisors disclose amendments or variant terms.

While the franchise disclosure laws have been enacted for the benefit of franchisees, ironically franchisors legitimately use the law to deflect or deny requests for modifications of the franchise agreement during negotiations. They say: "We can't do that for you because we simply can't do that for everyone and we definitely don't want to have to amend our UFOC." Of course, you can't ask someone to break the law. All this being true, my experience is that when franchisor wants to deal, they figure out how to make the deals work.

Franchisee rights may be broadly characterized as those expressly stated in the agreement and those implied (by law) by the legal relationship between franchisor and franchisee. Franchise agreements are typically one-sided documents, drafted by and for the benefit of the franchisor. They provide the franchisee with few rights and because of the inequality in size between the two parties, even less power to enforce those rights.

Franchise agreements customarily reserve to the franchisor the express powers to administer and enforce, in the franchisor's absolute discretion, quality standards, review and inspection procedures of franchised properties, specific programs and requirements for franchise system upgrades, the use of trademarks and branding in marketing and product or service offerings, and the rules affecting termination and/or renewal of the agreement. "Sole and absolute discretion" allows the franchisor to use its own judgment regarding how and when to exercise its rights under the agreement.

What can a franchisee do to ensure fair treatment? The law of every state requires that every agreement include an implied covenant of good faith and fair dealing. In general, the covenant requires each party to act in a manner consistent with the reasonable expectations of the parties. Those expectations are usually determined at the time the parties form the contract. Generally, the law allows parties the freedom to contract as they see fit, so long as the terms are not illegal or against public policy. So, if the franchise agreement unambiguously states the agreement, a court will not rewrite that provision. However, life is not



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always so clear.

During the course of a 10- to 20-year relationship, numerous situations arise that parties bargaining in good faith will not have addressed in the express language of an agreement. The situations may involve an evolving competitive landscape, technology innovations, cyclical economic conditions, mergers and acquisitions, etc. Franchisors and franchisees both have reasonable and good faith needs and desires to deal with these situations. Although the franchisor has greater power, franchisees are not without rights. Let's consider a few examples:

Exclusivity . A franchisee may have expected that the franchisor would not flag another property within a certain radius because the agreement stated so. Did the franchisee expect that five years later, the franchisor would have additional flags that would compete with the franchisee? First, we look to the contract but then in the absence of an express provision, courts have ruled that the franchisee has the right to expect that the franchisor will not act to destroy the right of the franchisee to enjoy the fruit of the contract.

Vendor relationships . Clearly, the franchisor has an important interest and obligation to ensure consistent quality throughout the brand.

However, should a franchisor be allowed to limit channels of distribution that significantly affect a franchisee's source of revenue? Fair dealing requires more than honesty. Bad faith may include abuse of power to specify terms, and interference with and failure to cooperate with the other party's performance.

Property upgrades . Clearly, the franchisor must implement programs that enable the brand to maintain its competitive positioning in the market. However, what is the timing? What are demands on the franchisees? Are they fair? Are they provided for in the contract?

Termination . The need to maintain standards speaks for itself; however, termination for cause and the imposition of resulting liquidated damages requires the franchisor to act in a commercially reasonable manner, giving fair warning and a real opportunity to cure any violations.

Franchisors do have discretion, and franchisees may not agree with the standards for exercise. That does not mean that the franchisor acted wrongfully, or that the franchisee can have its way. However, it does mean that franchisors can be held accountable when they overreach or act unreasonably. Understanding the meaning of the contract provisions and the franchisor's latitude in negotiations is critical to obtaining the optimal franchise relationship. Understanding the rules moderating franchisor discretion is essential to protecting and ensuring one's rights under franchise law.

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