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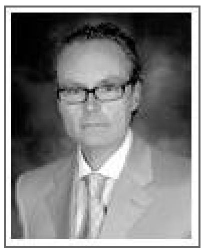

Message from the Chair
Four New Awards to Recognize Forum Members

By Edward Wood Dunham

Forum Chair

In August, Ron Gardner will succeed me as Chair of the Forum. My two-year term has flown by, made easy by the skill, energy, commitment and support of the members of the Forum Governing Committee; our annual meeting Chairs and presenters; the Directors and Steering Committee members of our three Divisions; the editors of The Franchise Law Journal and The Franchise Lawyer; the Forum's heart, soul and organizational savior, Kelly Rodenberg; and the Immediate Past Chair and Chair Elect, my good friends, wise counselors and always entertaining traveling companions, Dennis Wieczorek and Ron Gardner.

Many thanks to the Forum membership for giving me the opportunity to serve. It has been one of the great privileges of my life.

It is a great pleasure that one of my last acts as Forum Chair is to announce the establishment of four awards, intended to recognize important contributions by Forum members to the continued well-being of our organization.

Lewis G. Rudnick Award

Lew Rudnick, who died earlier this year, was one of the true giants of the franchise bar. He was among the founders of the Forum on Franchising, served as the Forum's second chair, and as a senior partner in his law firm trained several generations of some of America's leading franchise lawyers. Most important, Lew was a kind man and a consummate gentleman, who treated everyone with respect and demonstrated the personal qualities to which all lawyers should aspire.

The Rudnick Award will honor members of the Forum who, over the course of distinguished careers as franchise lawyers, have made substantial contributions to the development of the Forum and to franchise law

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as a discipline—by publishing scholarly articles; writing or editing texts; speaking at franchise law meetings; serving the Forum as an officer, committee chair or member, or journal editor; and/or recognized accomplishments as a practicing franchise lawyer—while comporting themselves in accordance with Lew Rudnick's high standards of professionalism, decency and collegiality.

Please send your nominations for the Rudnick Award to me at **edunham@wiggin.com**. Ron, Dennis and I will choose the recipient, subject to the approval of the Forum Governing Committee, and the inaugural award will be presented at the 32nd Annual Forum on Franchising this October in Toronto.

The Rudnick Award will honor a lifetime of achievement. The three other new awards are meant to recognize franchise lawyers at earlier stages in their careers, to encourage young and/or diverse practitioners to become and remain involved in the Forum, and to help them identify pathways to Forum leadership.

Chair's Award for Substantial Written Work or Presentation

This Award will recognize a young and/or diverse lawyer who has published a scholarly article in The Franchise Law Journal or The Franchise Lawyer, or prepared a paper and presented a workshop at a Forum annual meeting. Factors considered will include complexity of subject matter, competency of delivery, feedback from audience or readers, feedback from editors or program directors, and the relative experience of the author/presenter.

Chair's Future Leader Award

This award will go to a young and/or diverse Forum member who has demonstrated a substantial commitment to the Forum by undertaking significant leadership efforts, such as mentoring other Forum members or law students interested in pursuing careers in franchise law; work on membership marketing or other outreach efforts; assistance with special projects undertaken by the Forum Governing Committee or a Forum Division; or assisting with the Forum's annual meeting.

Chair's Explorers Award

This award is designed for newcomers to the Forum—a relatively new Forum member, an ABA member interested in joining the Forum, or a law student currently enrolled in an ABA-accredited law school and a member of the ABA Law Student Division—who have demonstrated an interest in pursuing a career in franchise law. Nominees will be asked to identify any activities that demonstrate their commitment, including prior attendance at franchise related conferences, contributions to the Forum, goals for future involvement in the Forum and any recommendations for Forum governance.

Any Forum member who is or has been a Governing Committee member or ad hoc member (e.g., Division Director, YLD Representative, editor-in-chief of The Franchise Law Journal or The Franchise Lawyer) is ineligible to receive a Chair's Award.

Please send any nominations for one or more of the Chair's Awards to me at **edunham@wiggin.com**. (Self-nominations, while not encouraged, will be accepted). Ron Gardner, Dennis Wieczorek and I will review all nominations and select the award recipients. The Chair's Awards will be presented at the Forum's Annual Meeting in Toronto.

You already had plenty of reasons to come to Toronto, but now you have some more—to learn which of your colleagues at the franchise bar will be recognized for their contributions and commitment, and to applaud (maybe even toast a time or two!) them for jobs very well done..

I look forward to seeing you in October.

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THE 2009 ABA FORUM ON FRANCHISING—LIKE ALWAYS, BUT LIKE NEVER BEFORE!

A quick review of the brochure for the **ABA Forum on Franchising's 32nd Annual Meeting** in **Toronto** on **October 14–16, 2009**, shows that this years' program captures what attendees have always liked about the Forum, while introducing some fresh new ideas that will give you every reason to attend.

This year's title and theme is ***The Architecture of Franchise Law: Engineering Excellence***. As in years' past, the hard work and thoughtful input of the ABA Forum's planning committee has yielded an excellent roster of programs, speakers, and networking events.

Like always, on Wednesday October 14, 2009, the Forum starts strong with three half-day intensive programs. In addition to the long-standing and ever-popular **Fundamentals of Franchising**® intensive program, there are two new additions to Wednesday's line-up. The **Successful International Franchising: The Legal and Business Considerations** program was created in recognition that now, more than ever, US franchisors are looking outside of their home market to take advantage of the better economic climate in other parts of the world. This program will help you, your client, or your company become better equipped to deal with international expansion. Equally exciting is the **MBA Concepts for Franchise Lawyers** program, taught by top franchise professionals, including the Controller of McDonald's Corporation. Come learn how the financial and business underpinnings of a franchise system and company apply to your transactional or litigation practice.

The main program promises to be equally impressive. This year's plenary session goes beyond talking "law" to franchise lawyers. Greg Nathan, a world-renowned franchise relationship expert, will be traveling from Australia to offer his ground breaking presentation on **Engineering Healthy Franchise Relationships**. This session promises to provide the "wow" factor that he brought to his workshop at the 2006 ABA Forum in Boston.

In addition, the main program workshops will provide attendees with the educational edge necessary to meet the legal and business challenges that franchisees and franchisors are facing in today's environment. Whether you want to learn more about hot topics such as **Franchise Systems in Distress,** or whether you want to discuss new trends on "bread and butter" issues such as **Best Practices for State Franchise Registration**, there is a program for you.

Like never before, this year's workshops include a newly developed series: **Fundamentals 201**. These two workshops—one transactional and one litigation—are designed to build upon the core principles learned in The Fundamentals of Franchising® program by teaching litigators how to litigate a franchise dispute and teaching transactional lawyers how to prepare an FDD. We are hopeful that these programs will help bridge the gap between our newer and more veteran attendees.

The opportunity to network and socialize with hundreds of franchise lawyers from different firms, companies and government agencies from around the world is not lost at this year's event. From museums to historical neighborhoods to Niagara Falls, the 2009 ABA Forum s social events feature some of the city's and region's best venues. Toronto offers so much, is so close, and is very affordable (thanks to the current exchange rate). October is a beautiful time in the city, with the Fall colors in full bloom, seasonal daily high temperatures of 55°, and comfortably cool evenings.

Like always, and like never before, the ABA Forum on Franchising in Toronto is the place to be on October 14–16, 2009. Grab your passport and join us. We look forward to seeing you there.

Kerry Bundy
Faegre and Benson

Larry Weinberg
Cassels Brock & Blackwell LLP

2009 Program Co-Chairs

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Registration is now open.

Register online by clicking on the poster below.

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Nominating Committee Report

Edward Wood Dunham, Forum Chair

I am pleased to let you know that under the leadership of Dennis E. Wieczorek, Immediate Past Chair of the Forum, the Nominating Committee has nominated the following persons for two year terms commencing in August 2010.

Members of the Governing Committee at Large:

- **Leslie D. Curran** of Plave Koch PLC, Reston, VA
- **Joseph J. Fittante** of Larkin Hoffman Daly & Lindgren Ltd., Minneapolis, MN
- **Michael D. Joblove** of Genovese, Joblove & Battista PA, Miami, FL

An election will be held at the Annual Business Meeting of the Forum on Friday, October 16, 2009 in Toronto, Canada.

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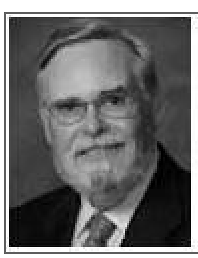

The Wisdom of Mediating Franchise Disputes

In the Winter 2009 issue of the *Franchise Law Journal* Editor-in-Chief Deb Coldwell predicted an increased use of mediation to resolve franchise disputes. She observed that the increasing cost of litigation and arbitration makes pre-litigation mediation an attractive alternative.

Certainly mediation is the most cost-effective way to resolve disputes after direct negotiation has failed and litigation appears inevitable. Parties who negotiate solutions through mediation often save substantial amounts of resources. The money they would spend in a lawsuit or arbitration proceeding on attorneys, expert witnesses, discovery and other litigation-related expenses can be reduced significantly. The parties also avoid the tiresome and costly draws on management time and energy a lawsuit or arbitration proceeding consumes.

But mediation offers valuable benefits in addition to cost effectiveness. Among them are:

- **Party supremacy**—In a mediation the parties themselves search out and approve a resolution of their dispute. They decide whether—and on what terms—to end the conflict; no judge or arbitrator dictates an outcome. A mediator helps the parties along by facilitating introspection and analysis, but does not render a decision or compel the parties to reach a mediator-ordained result.
- **Tailor made solutions**—In a mediation the parties enjoy freedom to craft a settlement that mirrors their particular needs and capabilities, which a court or arbitrator might lack authority or the vision to impose. For example if a debt is involved, the parties not only decide the amount to be repaid, but also decide the pay-out period, the interest rate and how the obligation will be secured.
- **Mutually beneficial results**—Mediation avoids the adversarial, win/lose confrontations inherent in our judicial system. To reach a mediated settlement, the parties must hammer out an agreement that benefits both sides. The negotiation process usually requires that both parties compromise and accept less than they might gain through a judgment or arbitration award. But neither side suffers a rejection of its legal position or denial of rights it believes are justifiably due. And both sides avoid the expenses of trial or an arbitration hearing.
- **Reconciliation and restoration**—Often the parties' relationship will survive a dispute's resolution. In appropriate circumstances, a mediator can help the parties restore their relationship to a mutually respectful state. Franchise disputes usually fit that mold; disputes between franchisors and franchisees (or franchisee associations) more frequently produce deep bruises than mortal wounds. For settlement in these cases to produce enduring results, feelings of mistrust and hostility that built up as the dispute escalated must be dissipated. The mediation process is especially suited to defusing emotional tensions and allowing parties to envision and commit to a healthier, more respectful relationship.

Why these benefits are available and how they can be achieved is best understood against a backdrop of the way mediation works and the approaches mediators use to engage parties in productive conversation.

Mediation is a private process in which an impartial third party (the mediator) helps disputing parties talk through the issues that divide them and agree on a way to end their conflict. The mediator acts as a facilitator; he or she sits neither as a judge nor as an arbitrator and does not render a decision. Statements the parties make to each other in joint sessions and to the mediator privately are confidential and may not be introduced into evidence if the matter goes to trial. Frequently the mediator's challenge is to help settle a claim, resolve a disagreement or end a relationship. In these cases the mediator essentially steers the parties through a stylized exercise in problem solving. If the parties' relationship will continue after the dispute ends and the quality of the relationship appears important, the mediator may also promote reconciliation and harmony. In these cases the mediator encourages the parties to engage in dialogue about accountability, collaboration and mutual respect.

There are at least two broadly recognized approaches to mediation: caucus model mediation and interest-based mediation. A third approach, called narrative mediation, began emerging earlier in this decade.

A caucus model mediation typically begins with a joint session which all of the parties and their advisors attend. The mediator opens with an explanation of the mediation process and invites the parties attorneys to take turns outlining their clients' claims and legal positions. The parties may make their own statements, but frequently rely on their attorneys to speak for them. Afterwards the parties adjourn to separate rooms for private conversations with the mediator, commonly called caucuses.

The real work occurs in the caucus rooms. The mediator begins a caucus session by asking probing questions about the party's legal position and expectations. The mediator separately encourages both parties and their advisors to think analytically and realistically about their claims' strengths and weaknesses and the probability of success at trial. After this exercise concludes with both parties, the mediator invites one of the parties to make a settlement proposal, which the mediator conveys privately to the other party. The parties evaluate and exchange offers and counter-offers through the mediator until they either reach a compromise both can accept, or decide that moving forward with litigation is their best alternative.

An interest-based mediation usually begins with a joint session during which the mediator explains the process and sets the tone. But in addition to allowing the parties attorneys to explain their clients' legal positions, the mediator invites the parties themselves to express their goals for the mediation—the outcomes they would most like to see occur. The mediator encourages the parties to express their goals in terms of the needs and interests they want satisfied and uses probing questions to help the parties engage in deep introspection. These questions often allow the parties to surface non-monetary needs they want met, such as a desire for an apology or expression of respect from the other party, for a quick end to the dispute's emotional toll, or for a change in the ways the parties communicate and interact.

As the parties express their needs and interests, the mediator jots them down. When the mediator's questions produce no additions to either party's list, the mediator calls a time out. The mediator uses the time out to compare the lists for expressions of common and divergent interests and to draft a problem statement that summarizes the goals the parties say they want to meet. Then the mediator calls the parties back together and invites them to edit the problem statement. When the parties satisfy themselves of the problem statement's adequacy, the mediator invites them to brainstorm options to resolve the problem and then to negotiate an agreement around the options they both consider acceptable.

Sometimes a mediator suggests that the parties suspend the joint session and move into separate rooms. The mediator may want to explore an issue that might require a party to disclose confidential information. Or the mediator may see that a party needs to consult with his or her attorney about a legal position or the merits of a particular option. But in contrast to a caucus model mediation, the real work of an interest-based mediation occurs in joint session where the parties listen to and observe each other.

Narrative mediation assumes that people create reality through the stories they tell. When irritants begin to invade a relationship, the parties talk about the situation to themselves and to others by telling stories. As a conflict deepens, these stories increasingly stress conflict elements in the relationship and ignore elements of cooperation.

A mediator tackles a relationship conflict by helping the parties understand that the conflict's source is not a personality disorder or moral flaw in either of them, but an external event or situation that has infected their relationship. The mediator encourages the parties to externalize the conflict by giving it an impersonal name—such as "this disagreement over reporting deadlines"—and then to attack the conflict as a common enemy. The mediator also uses probing questions to entice the parties to map the conflict's effect on their relationship and to draw out points of forgotten or neglected cooperation that contradict the conflict story. The mediator builds on these points of cooperation to help the parties author a story of a conflict-free relationship. If that story emerges and both parties are willing to adopt it, the mediator helps the parties agree on and accept accountability for the steps each will take to create and perpetuate a healthy relationship. A narrative mediation resembles an interest-based mediation to the extent the parties play a more active role in the conversation than their attorneys, and the heavy lifting occurs in joint session rather than caucuses.

Caucus model mediations are especially suited to settling claims in which the validity or collectability of a monetary obligation is at issue or in which an insurance adjustor controls the settlement amount. Although mediators who use this model learn ways to defuse emotions and control irrational behavior, their principal goal is to help the parties find a dollar amount and payment terms all can accept or to explore ways to wrap up a relationship that cannot survive the dispute. In the franchise context the caucus model approach is ideal for settling franchisor claims for delinquent royalties, inventory purchases and similar debts, assuming the franchisee has not withheld payment on account of a clash over system standards or perceived inequity in the franchisor's treatment of the franchisee. The approach is also suitable for settling termination actions if both parties want to end the relationship.

An interest-based or narrative approach is more suitable when the parties not only want to settle a debt or contract claim, but also want to eliminate hostility and resentment from an ongoing relationship. In these cases the parties need to negotiate for solutions that affirm mutual respect and restore trust. If for example a dispute relates to unpaid royalties, but the franchisee feels justified in withholding payment on account of unkept promises of financial support the franchisee believes the franchisor's CFO made, a settlement that addresses the royalty issue, but leaves untouched the franchisee s resentment toward the CFO will likely not produce enduring peace. The franchisee s mistrust and hostility will persist and may eventually erupt into overtly aggressive behavior, such as bolting the franchise system or leading the charge to form a confrontational franchisee association.

Interest-based mediation promotes settlement by exploring for common interests and seeking solutions that reconcile those interests. This approach can prove effective in laying a particular dispute to rest. However, if the parties fail to address needs and interests they do not share in common, the potential for the settlement to unravel at a later time persists.

Narrative mediation attempts to move beyond settlement. Its goal is to restore harmony to a previously healthy relationship on terms both parties not only accept, but embrace. Whether narrative mediation can achieve its goal in the context of commercial relationships remains to be tested.

Narrative mediation was first used in divorce and child custody cases and has recently been adapted to deal with conflicts involving co-workers or juveniles. To date there have been no documented cases of a mediator's using narrative principles to resolve a franchise dispute, and there are several reasons why a narrative approach may have limited utility in a franchise context.

In domestic relations and workplace disputes the parties are individuals who have a heavy personal investment and emotional stake in the soured relationship. A franchise dispute may involve an individual franchisee, but the franchisor is invariably a business entity. The involvement of a business entity introduces differences that may limit a narrative approach's effectiveness. A business is motivated by financial, legal and competitive interests, not by human emotions. A party to a mediation who has no emotional stake in the outcome cannot engage in dialogue at the level a narrative exercise requires. Also, individuals who represent a business entity at mediation often have no direct involvement in the events that triggered the conflict. They cannot share the passion an individual opponent experiences and frequently lack the position or authority to consider alternatives that might be required to author a story of a conflict-free relationship. In resolving a franchise dispute, the franchisor's representative must also stand guard over the entire system and resist making concessions to an individual franchisee that might weaken or compromise system standards.

Despite these limitations, a mediator can incorporate several narrative mediation techniques into his or her toolbox and use them to heighten the effectiveness of an interest-based approach. In identifying the problems mediating parties need to address, a mediator can encourage the parties to externalize and name the conflict and to attack it as a common enemy. This maneuver prompts the parties to resist blaming each other for creating the conflict and to focus instead on their own accountability for creating and maintaining a conflict-free relationship. A mediator can also invite the parties to describe their experiences with the conflict through story telling as a way to tease out needs and interests. And a mediator can lead the parties through an exercise in mapping the conflict's impact on their relationship not only to explore needs and interests but also to surface possible solutions.

Whatever style of mediation a mediator uses, he or she should concentrate on opening passageways for the parties to explore collaborative solutions to their problems. Collaborative interaction encompasses three characteristics: candor, creativity and flexibility. If a mediator creates an environment conducive to collaborative interaction and the parties take advantage of the opportunity, many benefits readily flow from mediation, including those I mentioned at the beginning of this article.

Of course, not every dispute can or should settle through mediation. Sometimes the importance of establishing a legal precedent or obtaining a judicial interpretation of a contract provision overrides the benefits of a mediated settlement. And not all disputes settle; one or both parties may decide that compromise either comes at too high a price or impinges too heavily on principles. But even a mediation that ends in an impasse can improve the parties understanding of each other's perspectives and reduce the hostility an adversarial proceeding often engenders. All things considered, a commitment to mediation as the court of first resort offers a wise alternative to a pell mell rush toward litigation or arbitration.

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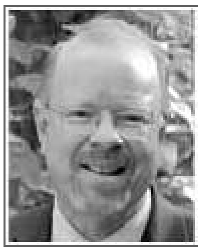

Are Franchise Lawyers Liable to their Clients' Franchisees for Negligent Misrepresentation?

By Howard E. Bundy

Bundy Law Firm PLLC

Since the beginning of franchising time (about 1970 or so), franchise lawyers have wondered, worried and whispered about whether they could be liable to franchisees of their franchisor clients and under what circumstances. Perhaps the franchise bar has been so concerned by what the answer might be that they have been unable to even discuss the question. Perhaps it is time to examine the elephant in the room.

Lawyers have long understood that, should they become a participant in fraud committed by their clients, they face serious disciplinary action by most bar associations. Although a violation of the Model Rules of Professional Conduct is generally not, by itself, a basis for civil liability (see MODEL RULES OF PROFESSIONAL CONDUCT "Model Rules" pmbl., para. 20 (2004)), everyone understands that the Model Rules establish a baseline as to the standard of care. Violation of that standard of care can lead to liability if it causes damages to a third party—even if that third party is not the lawyer's client.

Franchise lawyers have historically believed (or at least hoped) that the only basis for liability to third parties was if they participated in their client's fraud. That conclusion is easy to believe—but may not be either safe or justified. This belief may arise from a dangerously narrow reading of the Model Rules and without considering certain key case law on the subject, much of it arising in the securities context, but equally applicable in franchising.

Under Model Rule 4.1(a), it is a violation for a lawyer to "make a false statement of material fact or law to a third person." The violation is limited to "mere omissions of material facts" only if given in assistance of a criminal or fraudulent act by a client. Model Rule 4.1(b). And, it is only the "material omissions" that are limited by the language "unless disclosure is prohibited by Rule 1.6 [client confidences]." *Id.*; see Model Rule 1.6. Under the Model Rules, every lawyer who knowingly makes a false statement in a franchise disclosure document (even if done at the direction of a client) could be subject to disciplinary action. One should keep in mind that even Model Rule 1.6 is not an insurance policy. Although the disclosure of information in accordance with Model Rule 1.6(b) is permissive ("[a] lawyer may reveal information"), query whether this permissive right to reveal client confidences (even material omissions) could give rise to an affirmative duty on the part of a franchisor lawyer to take some action to protect innocent investors in the client's franchise system. In most states, it is fraud or actionable misrepresentation to fail to disclose a material fact. If the franchisor seeks to hide a material fact and the lawyer knows about it and assists or acquiesces, is that not a violation of Model Rule 4.1?

The Restatement (Third) of The Law Governing Lawyers lists several circumstances where a lawyer may be liable to a nonclient for negligence. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS "Restatement" §51 (2000). Comment b to Restatement §51 provides the following rationale: "Lawyers regularly act in disputes and transactions involving nonclients who will foreseeably be harmed by inappropriate acts of the lawyers. Holding lawyers liable for such harm is sometimes warranted."

Restatement §51(2) provides that a lawyer owes a duty:

> (2) to a nonclient when and to the extent that:
>
> > (a) the lawyer or (with the lawyer's acquiescence) the lawyer's client invites the nonclient to rely on the lawyer's opinion or provision of other legal services and the nonclient so relies; and
> >
> > (b) the nonclient is not, under applicable tort law, too remote from the lawyer to be entitled to protection.

Often without direct citation, courts in a number of jurisdictions, including the Third and Sixth Circuits, the Washington Supreme Court and the California Court of Appeals have followed the same logic in holding lawyers accountable to a nonclient for preparing a false or misleading document, the purpose of which is to influence a nonclient's business conduct.

The California Court of Appeals reversed a trial court order of dismissal in *Courtney v. Waring*, 237 Cal.Rptr. 233 (Cal Ct. App. 1987). In *Courtney*, the plaintiff franchisees alleged that the defendant attorneys knew material facts, including the fragile financial condition of the franchisor, and failed to disclose those facts in the Uniform Franchise Offering Circular. *Id*. at 234-235. The *Courtney* decision reversed a trial court summary judgment in favor of the attorney defendants, holding:

> Plaintiffs allege that defendants negligently prepared a franchise prospectus which failed to disclose material information known to defendants but unknown to plaintiffs. Defendants knew that the prospectus would be shown to prospective franchisees and that the information contained in it would be used to induce these persons to purchase TRU franchises. In simple terms, defendants are alleged to have prepared a false and/or misleading document, the purpose of which was to influence plaintiffs' conduct. It is the attorney's knowledge regarding the purpose of his work-product which . . . establishes a duty to those whose conduct has been influenced.

Id. at 239. Without citing it directly, the *Courtney* court's analysis is borrowed directly from the Restatement (Second) of Torts which provides:

> (1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

> (2) Except as stated in Subsection (3), [which pertains to the liability of one who is under a public duty to furnish that information] the liability stated in Subsection (1) is limited to loss suffered (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

RESTATEMENT (SECOND) OF TORTS §552(1), (2) (1977).

At about the same time that the California court was deciding the Courtney case, the Washington Supreme Court directly adopted §552 of the Restatement (Second) of Torts in a case involving liability of attorneys in connection with a bond offering. *Haberman v. Washington Public Power Supply System*, 744 P.2d 1032 (Wash. 1987). In Haberman, the Washington court explained that it is not necessary to prove that the attorney knew the identity of the plaintiff who received the bond offering. Instead, it is enough that the attorney intended that the document would reach and influence a person or group of persons in their business decisions or that he knew that his client intended to re-transmit the bond offering to some foreseeable person or group of persons in an effort to influence them in making a business decision. *Id*. at 1068. Fifteen years later, the Washington Supreme Court expanded the scope of the *Haberman* case to include certain opinions as to facts and by rejecting the defense of contributory negligence of the plaintiff. Lawyers Title Ins. Corp. v. Baik, 55 P.3d 619 (Wash. 2002).

The Colorado Supreme Court also addressed the attorney liability issue in a bond-related context in *Mehaffy, Rider, Windholz & Wilson v. Cent. Bank Denver NA*, 892 P.2d 230 (Colo. 1995). The *Mehaffy* case involved opinion letters from an attorney that the court characterized as "comfort letters," which the attorney and his client both knew would be delivered to some prospective bond investors. *Id*. at 233-35. The opinion letters contained false statements of fact. *Id*. at 237. In reaching its decision, the court rejected notions of privity and adopted §552 of Restatement 2d. *Id*. at 236. The court specifically reviewed the law applicable to other professionals and concluded: "A theory of negligent misrepresentation is proper where a professional knows that its representation will be relied upon by a non-client for business purposes." *Id*.

The Sixth Circuit, reviewing a case under Michigan law, held that the attorneys who participated in drafting a securities offering circular were liable to the investors in those securities where the attorneys knew the truth as to certain facts, but failed to disclose them. *Molecular Tech. Corp. v. A1 Valentine*, 925 F.2d 910 (6th Cir. 1991). The court noted that liability arose from the fact that the attorneys knew that prospective investors would rely upon the offering circular. *Id*. at 915-17.
Similarly, in a case involving an opinion letter issued to a client that the attorney knew would be passed on to investors, the United States District Court in Atlanta reviewed both Georgia and Pennsylvania law and concluded:

> Both Pennsylvania and Georgia recognize a cause of action for negligent misrepresentation in business transactions as set forth in §552 of the Restatement (2d) of Torts (1977) . . . [L]iability is not based on the breach of a duty a professional owes his clients or others in privity, but on an independent duty to plaintiff based on [the professional]'s manifest awareness of plaintiff's reliance on the opinion and intention of the plaintiff to so rely.

Horizon Financial, F.A. v. Hansen, 791 F.Supp. 1561, 1574 (N.D. Ga. 1992).

The United States District Court for the Southern District of New York, applying New York law, reached a similar conclusion in *Crossland Savings FSB v. Rockwood Ins. Co*., 700 F.Supp. 1274 (S.D.N.Y. 1988). The court, however, characterized the action as one for "malpractice" based on the attorney's issuance of an opinion letter to her client that the attorney knew the client would re-transmit to prospective investors in the client's venture. *Id*. at 1282-83.

The common theme of all of these cases is that lawyers are liable to victims of their negligence on the same basis and to the same extent as any other tortfeasor. The duty is measured by the lawyer's knowledge (or acquiescence) that his or her work product will reasonably be relied upon by a third party in making a business decision. Some of the cases cited above deal directly with the traditional "defenses" of lawyers to such liability—rejecting any concepts of privity, of conflicts of interest, and of client confidentiality. Regarding conflicts of interest and client confidentiality, the cases hold or suggest that, by directing the attorney to prepare a document for dissemination to third parties on which everyone realizes the third parties will rely in making business decisions, the client (franchisor) has implicitly, if not directly, waived confidentiality and any potential conflict of interest as to the matters required to be disclosed. As to privity, these courts tend to either brush it aside as "obsolete" or they define it in the terms of §552 of the Restatement (Second) of Torts to extend liability to those within the group or class that the lawyer should have understood would be entitled to rely upon the document.

Although most of these cases have arisen in the securities context, they are equally applicable to franchising—a disclosure protocol based closely upon the disclosure requirements and anti-fraud provisions of the securities laws. In franchising, as in securities, part of the public policy is to provide the prospective investor with a baseline of material information upon which to make a decision. The prospective investor, as a matter of law, is entitled to rely upon the accuracy and completeness of the disclosure document. The public policy is that no person—not even an attorney or other professional—is exempt from liability to a franchisee if that person, directly or indirectly, inserted a false statement of a material fact in a franchise disclosure document or failed to disclose a fact known by that person which fact would be material to a reasonable prospective franchisee. It certainly stops one of the ultimate frauds worked on franchisees—where the franchisor defends based on reliance upon advice of counsel and the complicit lawyer is immune to liability because of arcane concepts of privity, client confidentiality and conflicts of interest.

One must ask whether the developing law holding lawyers accountable for negligent misrepresentation in conjunction with preparing their franchisor clients' franchise disclosure documents serves a public policy interest. Historically, lawyers have argued that imposing such duties interferes with their duty of loyalty to their client and places them in a conflict of interest. Increasingly, however, courts are weighing those interests against a greater public interest—a public interest embodied in the franchise laws and regulations favoring full, honest and complete disclosure of material information to prospective franchisees. The courts have not imposed an obligation on counsel to confirm every fact provided to them by their client, but courts are increasingly holding lawyers responsible if they knew or reasonably should have known that the documents they were preparing contained false statements of material facts or failed to disclose required material facts. Similar to the way the law holds product manufacturers liable to ultimate consumers with whom they had no privity for product defects that they knew their buyer would pass on to the consumer, the law is coming to hold every person in the production chain of franchise disclosure documents accountable for their actions and omissions that result in untrue or incomplete disclosures.

It is important, regardless of what one thinks the law ought to be, for franchise lawyers to understand that, when they are preparing franchise disclosure documents that they know their clients will use to induce prospective franchisees to invest, the law may force them to serve two masters. The lawyer may not be required to confirm the accuracy of every fact disclosed, but if the lawyer knows the truth and fails to disclose it—or prepares a disclosure document that falsely suggests the opposite—the lawyer may be liable to the client's franchisees.

Note from the Editor-in-Chief: *Recognizing that there are differing views as to what the law is or ought to* *be on the issues presented in this article, we plan to include a counter-point article in the Fall 2009 issue of this publication. This article is meant to be thought provoking and to generate free and open debate on this important issue, which is a hallmark of the ABA Forum on Franchising.*

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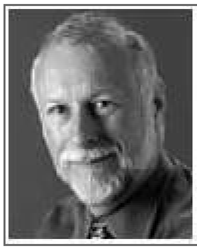

It's All About the Trademark

By Howard Caplan

A central and defining element of a franchise system, in nearly every case, is the licensing of a trademark. Indeed, in *Susser v. Carvel Corporation,* 206 F.Supp. 636 (S.D. N.Y. 1962), *aff'd*, 332 F.2d 505 (2nd Cir. 1964), the court opined that "the cornerstone of a franchise system must be the trademark or trade name of a product. It is this uniformity of product and control of its quality and distribution which causes the public to turn to franchise stores for the product." *Id.* at 640. Although *Susser* was an antitrust case involving tying and product pricing, the Second Circuit nevertheless expressly acknowledged the lower court s "trademark as a cornerstone" statement. Indeed, the fact that franchisors require franchisees to use the franchisor's marks, in particular the franchisor's name, is a major factor in the growth of a franchise and its goodwill. Hence, the plethora of cases addressing trademark control in post-termination situations. *See generally* Ann Hurwitz & Rochelle B. Spandorf, *Building Franchise Relationships,* 239-244 (American Bar Association, 1996).

Franchisors Without a Federally Registered Mark

While the new FTC Franchise Rule defines a franchise, in part, as being "associated with the franchisor's trademark," *see* 16 C.F.R. § 436.1 (h)(1), it does not require that the franchisor s trademark be registered as a condition of the offer and sale of a franchise-or in fact that it ever be so registered Similarly, the majority of the registration states define a franchise, in part, as being "substantially associated with" the franchisor's trademark.

The FTC Rule, like the old UFOC format, requires disclosure of the status of any pending trademark registration application with the PTO. But the UFOC Guidelines required the franchisor to state:

> By not having a Principal Register federal registration for (name or description of symbol), (Name of Franchisor) does not have certain presumptive legal rights granted by a registration.

The new FDD requires the following disclosure:

> We do not have a federal registration for our principal trademark. Therefore, our trademark does not have many legal benefits and rights as a federally registered trademark. If our right to use the trademark is challenged, *you may have to change to an alternative trademark, which may increase your expenses*.
>
> Item 13A Instructions iii, *Uniform Franchise Offering Circular Guidelines General Instructions*;16 C.F.R. § 436.5 (m)(4) (emphasis added).

Examiners and other representatives from registration states with whom the author has communicated have indicated that the lack of registration of the franchisor's name mark (and other marks) may also need to be disclosed as one of the risk factors on the state cover page. The above cited FDD disclosure was identified as approved wording for this risk factor, which would be required to be stated in capital letters on the state cover page.

As a result of these requirements, a franchisor not yet having registration of its brand name may want to consider avoiding doing business in the registration states until the registration is secured. This could mean not making offers or sales (a) in the state, (b) to a resident of the state, or (c) for a franchise to be operated in the state.

As the owner of a registered or unregistered trademark, a franchisor has the right to change its mark for any reason at any time. Standard in most franchise agreements is the requirement that the franchisee change its signage and other mark-bearing materials if the franchisor changes its mark. It is also common for franchise agreements to require that the franchisee bear the cost of replacing all mark-bearing items. In the absence of registration, this should raise a red flag to both franchisee and franchisor counsel; franchisor counsel is obligated to inform the franchisor of the potential difficulty of selling franchises without the assurance of being able to use the brand name and of the likelihood of having to negotiate around this obstacle.

Franchisee counsel needs to advise the prospective franchisee that there is no guarantee to continued use of the franchise brand name and seek to amend the franchise agreement by adding provisions similar to the following:

- If Franchisor's mark changes because of the inability to secure registration on the Principal Register of the United States Patent and Trademark Office, Franchisor will reimburse Franchisee for the full amount of replacing signage, stationary, marketing materials and any other items comprised of or bearing Franchisor's mark. Franchisee reserves the right to provide Franchisor with good faith estimates of the cost of required replacements and will not be required to commence such changes until Franchisor has paid or placed in escrow an amount equal to the good faith estimates.

- Franchisor warrants that it owns its marks and agrees to indemnify Franchisee from any losses or damages resulting from any third party trademark infringement action.

- If Franchisor loses the right to lawfully use its name brand mark, Franchisee will have sixty (60) days following notice of the loss of the right to use the mark in which to notify Franchisor of Franchisee's intent to terminate the Franchise Agreement. Franchisee will be able to continue operating a [the type of] business in its location and/or territory under a name not confusingly similar to Franchisor's current or new name without violating any non-competition covenant contained in this Agreement.

The franchisor will likely object to the addition of any of the above provisions. In such a circumstance, the franchisee must decide if it is willing to assume the risk associated with becoming a franchisee of a system where the trademark is not federally protected.

Loss of the Trademark

When a franchisor fails to secure or loses the registration of its name, this can be fatal to the franchise system. Yet, case law addressing the failure to secure trademark rights or loss of trademark registration in the franchise context is sparse.

In a 40-year old case, a court held that there was a complete failure of consideration to the franchisee and awarded damages to the franchisee following termination of the franchise agreement. In *A to Z Rental, Inc. v. Wilson,* 413F.2d 899, (10th Cir. 1969), the Wilsons were granted a franchise but, before opening, both A to Z, the franchisor, and the Wilsons learned of a senior user of a similarly named business operating in the territory. A to Z encouraged the Wilsons to temporarily open under another name with the express understanding that A to Z would favorably and timely resolve the name issue with the senior user. A to Z failed to resolve the name issue and the Wilsons were forced to close their business. Later, but before bringing suit for breach of the franchise agreement due to the business closing, A to Z reached a partial agreement with the senior user. The court opined that the loss of the franchisors exclusive right to use its trademark, together with other breaches of the franchise agreement, constituted a material breach of the franchise agreement. The court awarded damages to the Wilsons.

Two later cases resulted in denials of motions for summary judgment brought by multiple franchisees on the issue of whether the loss of a franchisor's name constituted a material breach of the franchise agreements. In each case, the courts stated that there was a question of fact whether loss of the brand name mark rose to the level of a material breach of the franchise agreement.

In *Multistate Transmissions, Inc. v. Cooney*, Bus. Franchise Guide (CCH) ¶ 9556 (E.D. Mich. January 11, 1990), Interstate Transmissions, the franchisor, after a lengthy court battle, lost the right to use its name in a case filed by Interstate Batteries. Interstate Transmissions filed for bankruptcy and then changed its name to Multistate Transmissions. Many franchisees experienced substantial decreases in sales allegedly due to the loss of the brand name. These franchisees opposed the efforts of the franchisor to assume their franchise agreements under 11 U.S.C. § 365. The court distinguished the circumstances before it from *A to Z Rental* because the franchisees received substantial training, marketing, and technical assistance from the franchisor. Thus, the loss of the right to use the name was not a per se violation of the franchise agreement as a matter of law.

In another 1990 decision, *In re Convenient Food Mart, Inc.,* Bus. Franchise Guide (CCH) ¶ 9599 (N.D. Ill. April 9, 1990), Convenient Food Mart, the franchisor, lost the registration of its mark due to the trade name being deemed to be generic. Convenient Food Mart owned at least four other registered trademarks and had protectable trade dress. The business value of the remaining trademarks and trade dress formed the basis for the denial of summary judgment. Convenient Food Mart, unlike Interstate Transmissions, was not required to change its name; however, it could not prevent others from using the same or a similar name. The court denied summary judgment brought by the franchisees on the basis of breach of contact and commercial frustration.

A franchisor can also lose its registration by failing to follow PTO renewal requirements. For example, Speedee Oil Change Systems, Inc., failed to timely renew its SPEEDEE trademark registration. Speedee sold franchises in California with UFOCs that failed to disclose this important loss of its trademark registration. The California Department of Corporations brought an action against Speedee and its sub-franchisors for, among many other things, misrepresentation and violation of the California Franchise Investment Law resulting from the lapsed registration. The court stated that "[i]t is of singular importance to prospective franchisees that they be able to rely on the unimpeded use of the marks and logos." *People v. Speedee Oil Change Systems, Inc.*, Bus. Franchise Guide (CCH) ¶ 11,548 (Cal. Supr. Ct., March 4, 1997). Perhaps more important was the following statement from this decision: "[t]he fact that no franchisee suffered detriment because of the lapsed registration does not render the failure to disclose immaterial." *Id.*

The failure to secure registration or loss of trade name registration can be fatal to the franchisor. For example, not too surprisingly, both Multistate Transmissions and Convenient Food Mart went into bankruptcy. As a result, *A To Z Rentals, Multistate Transmissions*, and *Convenient Food Mart* together suggest that a franchisor should have multiple registrations (preferably including or solely design elements); have substantial franchisee interaction beyond initial training and providing operations and other manuals; and confirm with reasonable certainty the right to use its marks, and trade name in particular, in a prospective franchisee's territory. *Speedee* suggests that a trademark registrant must actively monitor its registration(s) and that the franchisor must communicate with both trademark and franchise counsel.

A business new to franchising and without federal registration of its trade name should anticipate having difficulty selling franchises and having to make unwanted concessions. These concerns could be cause for identifying potential claims in response to the annual audit letter from a franchisor's auditor.

Franchisor counsel should encourage the business owner contemplating franchising to immediately seek federal registration of its trade name, or change that name and seek registration under a non-confusing name. Counsel should also make sure that trademark renewal requirements are being monitored.

Franchisee counsel should confirm in writing that a prospective franchisee understands that the franchise is at peril without federal trademark protection of the franchsisor's trade name and seek protections should registration not be successful.

For both sides of the franchise relationship, it is indeed, all about the trademark.

Howard Caplan is the principal of the Caplan Law Firm, P.A. in Jacksonville, Florida.

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2009 ABA Forum on Franchising Announces Community Service Event

Call for volunteers to assist the Centre for Addiction and Mental Health in Toronto

The Women's Law Caucus and the Corporate Counsel Division invite you to attend this year's Community Service Event at the 2009 ABA Forum on Franchising. Volunteers are needed to support the Centre for Addiction and Mental Health ("CAMH") in downtown Toronto.

Who: 2009 Forum on Franchising Attendees
What: Community Service Event
When: 8:00 a.m. - 1:00 p.m., Saturday, October 17, 2009
Where: Centre for Addiction and Mental Health in downtown Toronto
Why: Give back to the community and mingle with your colleagues

About the Centre for Addiction and Mental Health

The CAMH is one of the world's leading research centers in the area of addiction and mental health and provides a wide range of clinical care, research, education, policy and health promotion to transform the lives of people who are at risk and are at different stages of their lives and illnesses. Each year, about 450,000 people receive in-patient or out-patient care at the CAMH.

How you can help and why

At the CAMH, we will participate in indoor landscaping and interacting with outpatients and short-term residential patients. No experience necessary—just bring an open mind. Break through the mystique of mental illness and help transform a life!

What does this have to do with the legal profession? More than we care to admit. Practicing lawyers experience mental health issues at a rate that is 8 to 15 times higher than that of the general population, and of 104 occupational groups, lawyers ranked highest in the number of professionals managing depression.

Please also consider making a donation to this worthwhile cause, individually and/or on behalf of your firm. You may make your donation by dropping off a check (made out to the Centre for Addiction and Mental Health) or cash at the ABA Registration Desk.

Transportation to and from the CAMH will be provided. Please join us for a Dutch-Treat lunch following the event.

If you have any questions regarding this event, please contact Brian Balconi at **Brian.Balconi@LCECORP.com** or Eunice Machado at **emachado@casselsbrock.com**.

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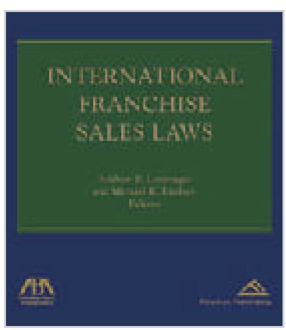
New Books from the Forum on Franchising



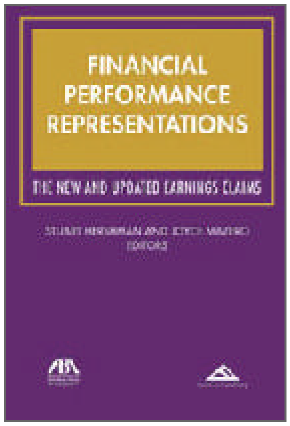
Product Code:5620119
Forum Member Price: $40.00
Regular Price: $60.00

International Franchise Sales Laws—2009 Supplement

Andrew P. Loewinger and Michael K. Lindsey, Editors

International Franchise Sales Laws addresses disclosure requirements in the countries of Australia, Brazil, Canada, China, France, Indonesia, Italy, Japan, Malaysia, Mexico, Romania, South Korea, Spain and Taiwan. This supplement features updates to sections on Australia, Canada and China. For each jurisdiction, two authors licensed to practice in the jurisdiction address the jurisdiction's disclosure requirements in a uniform format. Each country chapter is organized to provide a comprehensive discussion of each of the applicable laws and also a practical and easy-to-use reference for counsel to comply with those laws.

For more information or to place an order, click **here**.



[Financial Performance Representations: The New and Updated Earnings Claims]

Stuart Hershman and Joyce G. Mazero

This new book sheds light on all aspects of the earnings claim area, including defining what an "earnings claim" really is, the origins of its regulation under the franchise disclosure laws, how a franchisor should prepare an earnings claim, how a franchisee should use an earnings claim, how a franchisee may attack lawful and unlawful earnings claims, how a franchisor may defend against such attacks, and how the government franchise enforcement authorities, particularly the FTC, investigate and prosecute unlawful earnings claim activity.

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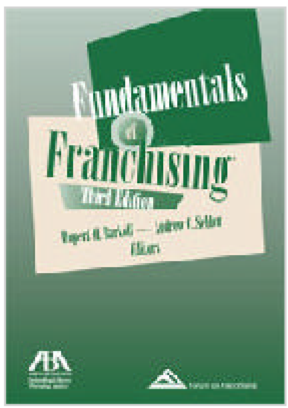

[Fundamentalf Franchising, Third Edition]

Rupert M. Barkoff and Andrew C. Selden, Editors

The new edition of *Fundamentals of Franchising* is charged with useful definitions, practical tips, and expert advice from experienced practitioners. Written specifically to help lawyers and non-lawyers brush up on franchise law, this practical guide examines franchise law from a wide-range of experiences and viewpoints. Each chapter is written by two experienced practitioners and provides you with a well-rounded overview of franchise law and alerts you to issues that may require further research or expertise.

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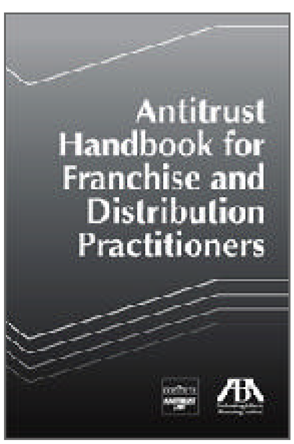

[Antitrust Handbook for Franchise and Distribution Practitioners]

Co-published with the ABA Section of Antitrust Law

Organized by issue—pricing and advertising, customer and territorial restrictions, exclusive dealing, purchasing constraints, and joint franchisee action—to enhance its usefulness to practitioners, this book will prove an invaluable aid to practitioners advising clients on antitrust issues involved in franchising, whether they are selling through a business format or product distribution franchise.

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