



The Franchise Lawyer

American Bar Association • Forum on Franchising

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THE FRANCHISE LAWYER

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[Message from the Chair](#)

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[First Lew Rudnick Award to John Baer](#)

In honoring Lew Rudnick's memory, the Forum honors not only his lawyerly achievements, but his contributions sharing his passion and curiosity with hundreds of aspiring franchise lawyers. John Baer of Sonnenschein Nath & Rosenthal is the recipient of the Lew Rudnick Award for 2009. John has given thousands of hours supporting and working for the Forum on Franchising. [Read more...](#)

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A group of Forum attendees generously volunteered their time at the Centre for Addiction and Mental Health in downtown Toronto, the site of the 2009 Annual Forum Community Service Event. Additionally, approximately \$1,200 was donated to the cause. [Read more...](#)

[How to Create Healthier Franchise Relationships and Happier Clients](#)

In some cases, the corporate culture of a franchise network will be an even more important determinant of franchisee satisfaction than financial performance. Lawyers can boost client satisfaction by including commercial and psychological perspectives, as well as legal expertise, when working on franchise relationship issues. [Read more...](#)

[Franchising and Social Network Marketing: Growing and Protecting Brands in the World of Tweets, Apps, and Fan Pages](#)

Social networking sites offer a low-cost opportunities for franchisors and franchisees to reach out to their customers and to promote their brands. However, with just a few keystrokes, third parties have the potential to quickly spread misinformation, cause confusion, and tarnish a company's hard-earned reputation. [Read more...](#)

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Depending on the rights and duties a franchisor grants to a franchisee under a particular multi-unit expansion

model, the franchisee may: (1) have no disclosure or registration obligations; (2) be subject to disclosure in the franchisor's FDD; or (3) be required to prepare its own FDD, separate and apart from that of the franchisor, or prepare a "joint FDD" with the franchisor. [Read more...](#)

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[Back to Top](#)

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INSIDE THIS EDITION

[Message from the Chair](#)

[Lew Rudnick Award to John Baer](#)

[The ABA Forum is now on Facebook!](#)

[Community Service Event](#)

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Message from the Chair

By Ronald K. Gardner

Forum Chair

"The best mix of programs ever." "Outstanding programming." "The best CLE of any sort I've ever attended." "I loved the museum." "The Forum has done it again!" These are just a few of the hundreds of positive comments that we have received in the last couple of months regarding the Forum's Annual Meeting last October in Toronto. Kerry Bundy of Faegre & Benson and Larry Weinberg of Cassels Brock, with the invaluable assistance of Kelly Rodenberg of the ABA Forums Department met, and in many ways exceeded, the Forum's proud history of putting on a spectacular Annual Program. Please join me in sharing our collective thanks one last time with Kerry, Larry and Kelly, along with all of the speakers and program directors, for making the Toronto Forum an overwhelming success.

The work of the Annual Meeting never stops. Already, the 2010 Program Co-chairs, Deb Coldwell of Haynes & Boone and Kathy Kotel of Carlson Restaurants Worldwide, have sifted through hundreds of program suggestions and speaker recommendations and have begun the task of formulating and putting together this October's program. The Planning Committee for the 2010 Forum has already conducted its site visit to the fantastic Hotel Del Coronado in San Diego, and a draft program is being put together as I put pen to paper. By late February, the entire Governing Committee will have weighed in on this draft, and by mid-March, speaker invitations will begin to be made. Thanks to all of the Forum members who have made topic suggestions, and thank you in advance to our speakers for 2010 (whoever you may be), for the hard work you are willing to give us in order to allow the Forum to continue to strive to meet its mission – to be the preeminent source of legal education regarding franchising in the United States. We look forward to sharing the product of all of this hard work with all of you between October 13 and 15 in San Diego. Be sure to mark your calendars now for this premier event.

Of course the annual program is not the only activity of the Forum. Watch your e-mail for informative teleseminars the Forum has planned for this coming year. Teleseminars are a wonderful way for people to stay connected to the Forum, learn valuable insights from their colleagues, and in many cases, receive needed CLE credits. We will continue to bring you this high quality alternative programming throughout the coming year. (And, to the extent you have a suggestion about topics you would like to see us cover in the teleseminars, please forward those suggestions to our Program Officer, Joe Fittante at jfittante@larkinhoffman.com.)

Finally, as I recently noted in a List Serve posting, the Governing Committee is undertaking a thorough review of the Forum's List Serv guidelines. The List Serv, as many of you know, provides a valuable day-to-

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day link to information sharing amongst Forum members. However, it has also been understood that without oversight, the List Serv could quickly devolve into something that was never intended – a commercial marketplace where the loudest and most frequent poster takes the resources of the List Serv and makes it his or her own. Currently we are examining ways that we can continue to provide a valuable resource to those looking for an instant education on a certain narrow topic, or a contact in a far away place, while simultaneously providing an outlet to the many and varied pronouncements our members feel they have a need to share. Finally, as I recently noted in a List Serv posting, we are considering a range of options, and simply ask for the patience of our members as we work through this delicate balancing process.

On behalf of all of the members of the Governing Committee, I want to thank the Forum members for their continued support, both financially and through attendance at our various programs. Without your continued support, our collective effort of teaching and learning together would be without purpose.

[Back to Top](#)

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INSIDE THIS EDITION

[Message from the Chair](#)

[Lew Rudnick Award to John Baer](#)

[The ABA Forum is now on Facebook!](#)

[Community Service Event](#)

[How to Create Healthier Franchise Relationships and Happier Clients](#)

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Lew Rudnick Award to John Baer

Earlier this year, franchising not only lost one of its true pioneers, but one of its finest gentlemen.

Lew Rudnick dedicated a large portion of his life to the development and refinement of franchise law. Among his many accomplishments, Lew was one of the founding members of this organization, and was its second Chair. He and his father, along with Phil Zeidman and other forward-thinking partners, were responsible for the creation of what has evolved into DLA-Piper, one of the most recognized franchise practices in the world.

As fellow practitioners and Forum members, however, those who knew Lew recognized in him a quality far greater than his acumen as a lawyer. In honoring Lew's memory, the Forum honors not only his lawyerly achievements, but his contributions in reaching out and sharing his passion and curiosity with hundreds of aspiring franchise lawyers. Whether you worked for, with or against Lew Rudnick, you were treated with dignity and respect. His commitment to mentoring the next generation of franchise law practitioners will result in his influence being felt in this area of the law and on this Forum in particular for many generations to come.

So in honoring Lew's memory, we honor a member of our organization who also exhibits these truly remarkable traits. Someone who, like Lew Rudnick, has committed a large portion of their life to helping mold our area of practice, and having done so in a way that shows respect and dignity to his colleagues and kindness and mentorship to those who have worked for, with and against him.

On behalf of the Governing Committee of the Forum on Franchising, I am so pleased to announce that the recipient of the Lew Rudnick Award for 2009 is John Baer of Sonnenschein Nath & Rosenthal.

John is known to almost everyone in the Franchise Bar. Besides his extraordinarily scholarly work as the author of CCH's Sales Representative Guide, John is the Chair of the Illinois Attorney General's Franchise Advisory Board and the Vice Chair of the International Franchising Committee of the International Bar Association's International Sales, Franchising & Product Law Section. John is also on the Board of Editors of LJN's Franchising Business and Law Alert.

Over the 32 years of its existence, John has shared thousands and thousands of hours supporting and working for the Forum on Franchising. John has spoken on countless occasions, mentored and taught hundreds of young lawyers, and done so with a smile and a helping hand. When called to contribute, John answered that call. John is a former editor-in-chief of the ABA Forum on Franchising's Franchise Lawyer,

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former associate editor of the Franchise Law Journal, a former member of the Governing Committee and during his tenure on the Governing Committee, a highly successful publications officer. John has also authored over a dozen Franchise Law Journal articles, always willingly, and perhaps more importantly, always meaningful and informative.

We once again congratulate John Baer, the first recipient of the Lew Rudnick Award.

[Back to Top](#)

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INSIDE THIS EDITION

[Message from the Chair](#)

[Lew Rudnick Award to John Baer](#)

[The ABA Forum is now on Facebook!](#)

[Community Service Event](#)

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[Message from the Chair](#)

[Lew Rudnick Award to John Baer](#)

[The ABA Forum is now on Facebook!](#)

[Community Service Event](#)

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2009 Annual Forum Community Service Event



On Saturday, October 17, 2009, a group of Forum attendees volunteered their time at the Community Service Event held at the Centre for Addiction and Mental Health in downtown Toronto. Additionally, approximately \$1,200 was donated to the cause. Thank you to all who contributed. At the event, working side-by-side with those who receive treatment, the group set out to make the space a more pleasant environment. On the way to this goal, those receiving treatment felt the support of the outside world while the volunteers were given a better understanding of mental health issues. Through a cooperative effort, the group planted tulip bulbs, covered them with top soil and then anticipated, with some faith and hope, that their efforts will pay off in the spring with a colorful bloom and a brighter day.

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INSIDE THIS EDITION

[Message from the Chair](#)

[Lew Rudnick Award to John Baer](#)

[The ABA Forum is now on Facebook!](#)

[Community Service Event](#)

[How to Create Healthier Franchise Relationships and Happier Clients](#)

[Franchising and Social Network Marketing](#)

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How to Create Healthier Franchise Relationships and Happier Clients

By Greg Nathan

Franchise Relationships Institute

Each professional discipline has its own unique perspective, shaped by professional tradition and training as well as the expectations of colleagues and clients. Franchise law is no exception.

The legal profession has done an excellent job at refining the art and science of the franchise contract. However the franchise relationship is more than the contract.

While a contract may signify the presence of a relationship, the contract is not the relationship, just as the power plug on a wall is not the electricity.

Psychologists define relationships as a feeling of connectedness that influences people's behavior. From this perspective, when we talk of a franchise relationship we are referring to how franchisees and franchisors feel about each other, particularly in relation to trust and commitment. While the franchisee is usually seen as a person, the franchisor can be seen as a management team, a company, a brand or as a person — usually the President of the company.

Through our research at the Franchise Relationships Institute over 20 years we have found there are predictable patterns in how franchisees and franchisors feel about each other, and that these feelings influence behavior in both constructive and destructive ways. We have also discovered proven strategies that franchisees and franchisors can adopt to manage their relationships more effectively.

For instance in companies that have healthy franchise relationships, as measured through objective questionnaires, we see the following behaviors:

- Franchisees and franchisor employees are glad of their decision to be involved in the network.
- There is collaboration and transparent sharing of information between franchisor and franchisees as well as between franchisees.
- Dealings between parties are conducted with courtesy and respect.
- People give each other the benefit of the doubt.
- People comply with their agreed obligations without coercion.

What franchisees want from franchisors

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When franchisors and franchisees recognize and respond appropriately to each other's needs there is less likely to be conflict and stress in the franchise relationship.

Based on our research there are five things franchisees want from their franchisor.

1. **Tools and processes that help the franchisee to build a profitable business.** Anything a franchisor can do to help a franchisee save money, drive greater productivity or increase their sales is likely to be well received.
2. **Marketing support that drives brand awareness and customer enquiry.** When asked to name the most important aspects of their franchise system, most franchisees mention the brand and services related to marketing.
3. **Leadership that is competent and trustworthy with a long term vision.** Leadership that gives franchisees hope is particularly important in tough times. Franchisors are more highly rated when they articulate believable strategies around protecting market share, boosting sales and building customer loyalty.
4. **To feel a respected part of their franchise network.** Many franchisees gain great security and satisfaction from feeling part of a network, particularly when they have the opportunity to interact with other franchisees.
5. **Concern for their success with relevant, responsive support.** We often hear franchisees saying they wish a franchisor representative would call them to ask how they are doing. Indeed franchisees rate a prompt response to phone calls and emails as highly important.

Note that these needs go beyond purely financial considerations. Our research shows that franchisee profitability, while important, is only one of the drivers of franchisee satisfaction.

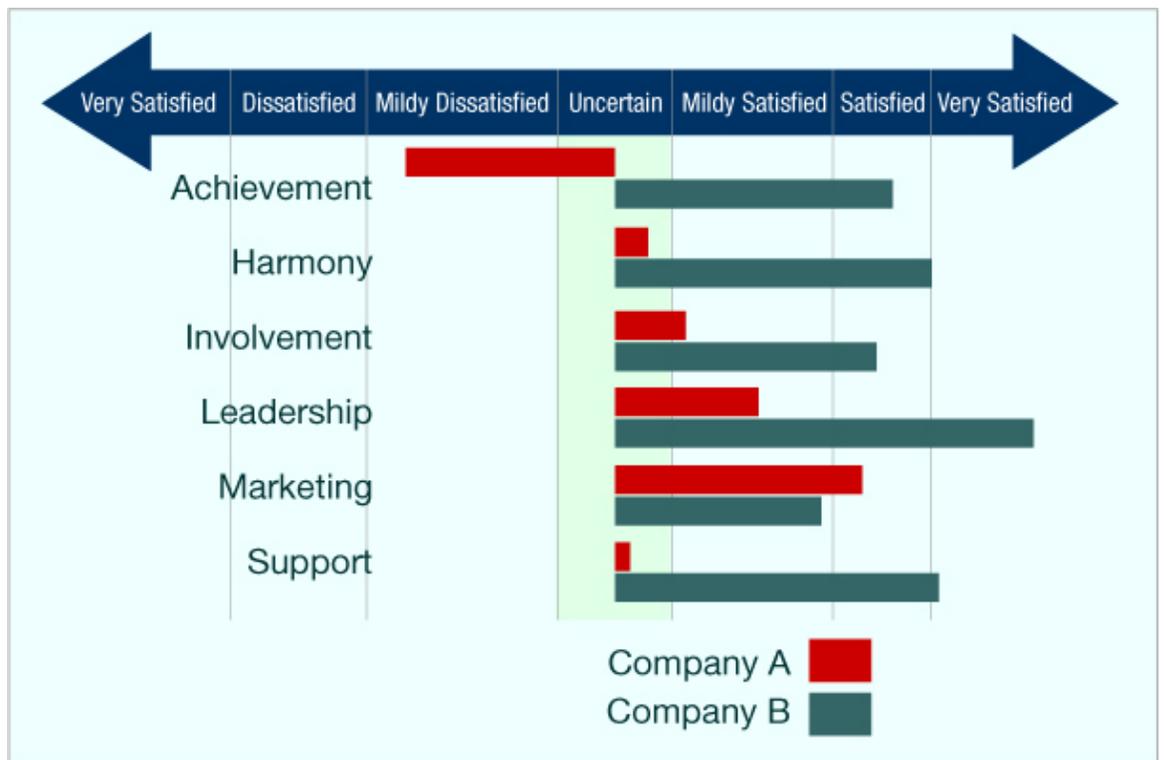
Take the following case study of two franchise systems, Company A and Company B. While both companies had been franchising for a similar time and were similar in size and industry category, they had distinctly different corporate cultures.

Company A was led by an authoritarian, task focused management team, obsessed with control and which habitually dealt with franchisee conflict in a confrontational manner. Their typical approach to dealing with franchisees was to catch them out for non-compliance and take a punitive approach by issuing breach notices. Only 50% of franchisees in this company believed their franchisor cared whether they succeeded or not.

Company B on the other hand was led by a people focused management team committed to collaboration and resolving conflict through open discussion. Their modus operandi was "be constructive, not destructive" and they focused on positive two-way communication and rewarding franchisees for good performance and behavior. In this company over 80% of franchisees believed their franchisor cared whether they succeeded or not.

Despite franchisees in Company A making on average of 30% more profit, the franchisees in Company B were significantly more satisfied on a range of measures including achievement, which included financial performance, as shown in Figure 1.

Figure 1 — Franchisee satisfaction between Company A and Company B



The point is that the corporate culture of a franchise network will have a significant impact on franchisee satisfaction. In some cases culture will be an even more important determinant of franchisees satisfaction than financial performance.

What franchisors want from franchisees

The franchise relationship is of course a two-way street and franchisor personnel also have five expectations of their franchisees which, if not met, can result in frustration and conflict.

1. **Maximize local market share and take responsibility for managing the business.** Franchisors expect their franchisees to be fully focused and involved on a daily basis on running their business and ensuring it is fulfilling its potential.
2. **Show loyalty and support for new product and marketing initiatives.** It is frustrating and disheartening for franchisors when franchisees are seen to resist initiatives for no logical reason.
3. **Respect the brand and maintain high operating standards.** While there is a trend by franchisors to move from being "cops" that police standards to "coaches" that help their franchisees to grow their business, this can only be achieved if franchisees are complying with brand standards.
4. **Provide accurate, timely financial information.** Many franchisors like to analyze market trends and provide performance benchmarks back to their franchisees. However they can only do this if they have the relevant data.
5. **Be pleasant to deal with and provide feedback in a constructive manner.** It is natural for franchisor executives to feel frustrated and defensive if they receive rude and unfounded criticism from franchisees, or if franchisees are hostile or disruptive in meetings.

When we show these mutual expectations to groups of franchisees and franchisors there is widespread agreement that if both parties focused on these areas the relationship would work well. However in the hurly burly of daily operations and when faced with economic pressures, either party can behave in ways that undermine these needs.

How franchise lawyers can add more value to their clients

As an independent third party, franchise lawyers are in a position to remind their franchisor and franchisee

clients of these mutual expectations - even facilitate constructive two way discussions around the needs of both parties.

However what is more likely to happen is aggressive or defensive posturing to prove a client's position is right while the other party is wrong. This tends to exacerbate an already strained franchise relationship, even if this is not the intention.

Of course lawyers do not always take a rigid legalistic approach and many disputes are resolved using more pragmatic approaches such as negotiation and mediation, which focus on interests, not positions.

In Australia franchisors and franchisees operate under a mandatory Franchising Code of Conduct with enforceable guidelines to participate in mediation, in the event of conflict. A recent review by the Office of the Mediation Advisor, the government funded body responsible for facilitating the mediation process, found that out of 1,116 mediations in Australia, a 78% settlement rate was achieved. While mediations were initially mainly instigated by franchisees when the service started in 1998, 30% of requests to use the service are now coming from franchisors.

Mediation represents one opportunity for franchise lawyers to move outside the traditional legal paradigm and take a fresh approach to contributing to healthy franchise relationships. Franchise lawyers we have spoken with who have been adopting this approach, report encouraging results in building stronger ongoing relationships with their clients who tend to include them as relationship advisers rather than ad hoc problem fixers.

Based on a 2009 US survey of 100 franchisor executives conducted by The Franchise Business Review, this is a fresh approach that more franchise lawyers might consider recommending to their clients. In this study 84% of franchisors rated their law firms as excellent on franchise expertise. However only 46% rated their law firms as excellent on "strategic counseling" or the ability to engage beyond legal technicalities to assist with broader business goals, including developing healthy franchise relationships.

For the lawyer looking for a competitive advantage, a more holistic understanding of the franchise relationship, encompassing legal, commercial and psychological perspectives, should prove useful. It is our experience that, like the legs of a stool, all three perspectives play an equally important role in creating a stable and robust foundation for franchisees, franchisors and lawyers to work effectively together.

In the Franchise Business Review Study franchisors were also asked to describe the biggest strengths of their law firms as well as the services that need the most improvement. The five strongest themes to emerge were:

1. Respond quickly and willingly to requests for help. Franchisors expect their lawyers to be flexible with their schedules and responsive to their requests. Some clients appreciated the efforts their lawyers made to make themselves available and deliver a quick turnaround. Several clients also said they appreciated the thoughtful personal contact they had with their lawyer.
2. Provide the best solutions for the least cost. Many clients appreciated their lawyers providing cost effective, practical solutions. The general consensus was that clients don't mind paying fees as long as there is evidence that the lawyer has made an attempt to be efficient and provide the best value possible. For instance, one client said, "I would like to see a reduction in our bills but at the same time I know that you get what you pay for."
3. Consider problems from a pragmatic business perspective. Clients who were most satisfied mentioned that their lawyers had good business sense and thought beyond the legal aspects of a problem. For instance, one satisfied client wrote, "They know our business and advise us in line with our strategic business objectives."
4. Keep track of important dates to ensure compliance with relevant State and Federal laws. Several

franchisors said they relied on their lawyers to help them manage compliance and provide counsel on FDD related issues. There were also several complaints that lawyers could be more diligent in this area.

5. Follow up with strategic advice and ideas based on work with other clients. Clients figure that their lawyers should be able to apply knowledge gained through other work to their business. However they are looking for more than generic legal updates — they expect advice to be made relevant to their specific business. For instance, in response to what their law firm could do to improve their service one client said they should stop "gratuitous legal updates and start sharing creative strategies for dealing with practical realities of the business."

In summary lawyers can boost client satisfaction by including commercial and psychological perspectives, as well as legal expertise, when working on franchise relationship issues. The opportunities are there for those willing to embrace a more holistic framework.

Greg Nathan is a registered psychologist, author of several franchising books, including *The Franchise E-Factor*, and Managing Director of the Franchise Relationships Institute. He delivered the keynote address on "Engineering Healthy Franchise Relationships" at the 32nd ABA Forum on Franchising in Toronto.

[Back to Top](#)

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INSIDE THIS EDITION

[Message from the Chair](#)

[Lew Rudnick Award to John Baer](#)

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Franchising and Social Network Marketing: Growing and Protecting Brands in the World of Tweets, Apps, and Fan Pages

By Jennifer Scannell
Baker Botts L.L.P.

These days, it seems like everyone is on Facebook, including the Forum. YouTube videos are playing on the nightly news. The revolution in Iran was documented via first hand accounts on Twitter. President Obama, Governor Schwarzenegger, and even Oprah are tweeting. Pope Benedict XVI has launched his own Facebook app, allowing followers to receive daily messages. Fans have set up Facebook pages for every topic imaginable, including sports teams, celebrities, local bands, and less expected topics - there are over 200 fan pages devoted to squirrels. Once the domain of college students and teenagers, social networking has exploded in popularity in recent years, and businesses of all sizes are taking notice.

In difficult economic times, social network marketing has emerged as a cost-effective way for franchise companies to reach new customers and to build brand loyalty among existing customers. Additionally, individual franchisees have harnessed the power of social network marketing to run local promotions targeted to their individual communities. However, franchisors and franchisees need to be aware of the potential risks involved with social network marketing, including negative comments, user name squatting, and possible tarnishment of the company's reputation.

What Are Social Networking Sites and Who Uses Them?

Millions of U.S. consumers use social networking sites on a daily basis. One study by Fox Interactive Media Research shows that more than 70% of Americans between the ages of 15-34 actively use social networks, and 40% of social networking site users said that they use these sites to gather information about brands and products they like. Fox Interactive Media Research: Social Networks Are a Good Advertising Platform, April 23, 2007, <http://www.pronetadvertising.com/articles/fox-interactive-media-research-social-networks-are-a-good-advertising-platform10019.html>. According to the 2008 Cone Business in Social Media Study, available at www.coneinc.com, 60% of Americans use social media, and of those, 59% interact with companies on social media websites.

Facebook, currently the most popular social networking site in the United States, boasts 200 million active members. Twitter, the fastest growing social networking site in the United States, has exploded in popularity over the last year. Ranked 22nd in popularity in 2008, Twitter is now ranked 3rd and appears to be moving up quickly. Twitter in particular is growing in popularity as a marketing tool for two simple reasons: it is easy to use, and it allows businesses to connect with consumers in real time.

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Why Social Network Marketing?

Why should franchisors and franchisees leap into this new area of marketing? First, because customers expect it. According to the Cone Business in Social Media Study, 93% of social media users believe a company should have a presence in social media, while an overwhelming 85% believe a company should not only be present but also interact with its consumers via social media. The study reports that 56% of users feel both a stronger connection with and better served by companies when they can interact with them in a social media environment.

Second, social network marketing allows small businesses to connect with hard to reach consumers. The Cone study reports that of men and younger consumers, traditionally the most challenging to reach, one-third believe companies should actively market to them via social networks. The same is true of the wealthiest households, where 2/3 of households with incomes over \$75,000 feel stronger connections to brands they interact with online.

Finally, social media networking is a cost effective way to spread the word and connect with customers. In the current recession, businesses of all sizes are looking for less expensive ways to market their brand. Social network marketing provides a vehicle through which individual franchisees can reach out to their communities, improving brand awareness and providing local content and targeted advertising. In addition, social media networking provides a low cost alternative for franchisors to attract new franchisees and grow their franchise systems.

Harnessing the Power of Social Network Marketing

Franchise companies throughout the country and around the world are finding new and inventive ways to use social networking sites to promote their brand. Franchise companies use Facebook pages to highlight current promotions and new products and to provide links to printable coupons. On some pages, customers are encouraged to upload photos and videos of themselves enjoying the companies' products. Other companies hold weekly sweepstakes drawings, or offer links allowing customers to purchase or download free iPhone apps related to the company's products or services.

Permitting and encouraging individual franchise locations to actively participate in a social network marketing campaign can benefit both the franchisor and the individual franchisee. This is particularly true for franchise locations outside of the United States. Franchisees around the world are hosting their own Facebook fan pages and Twitter accounts in the local language - enabling the individual location to highlight products and promotions of interest within the community.

The individual franchisee is often in the best position to anticipate and appreciate which promotions will appeal to the local community. Some franchisees use their local pages to offer special promotions or printable coupons specific to their individual location. For example, one restaurant franchisee offers its congratulations to the local high school's graduating seniors while offering Twitter-only discounts, and another suggests hosting a pizza party in conjunction with a local sporting event. In addition, franchisees can encourage team members and customers to post photos and videos to the local page. Some franchisees have run local contests on Facebook, in which customers submit short video commercials starring themselves. Encouraging customer involvement not only allows customers to connect with the product in a very personal way, but also provides valuable word of mouth advertising - at little or no cost to the franchisee.

Some Potential Risks in Social Network Marketing

Negative Comments

Any company that utilizes social network marketing will almost certainly, at some point, receive negative feedback on social networking sites. However, this risk can be turned to a company's advantage by embracing these opportunities to resolve customer complaints and to rectify problems of which the company

may have been unaware. Franchisees should also be encouraged to monitor social networking sites and to bring any negative comments or complaints to the attention of the franchisor. Numerous tools are available to help monitor what is being said about individual companies and brands. Twitter Search, available at <http://search.twitter.com/>, allows users to enter a franchise name, or a competitor's name, and see what is being "tweeted" on that subject. Franchise companies can also set up email alerts on TweetBeep, available at <http://tweetbeep.com/>, through which they will receive an email each time someone "tweets" about the company.

Inappropriate Content

It is vital that companies monitor social networking sites on which they maintain a presence for any inappropriate content. Offensive content should immediately be removed. Any third party content or statements which could be found to be false or defamatory should also be removed. Additionally, franchisees should monitor any postings by employees or team members for inappropriate content which could tarnish the reputation of the brand.

User Name Squatting

As more businesses are turning to Twitter and other social networking sites, problems with user name squatting are emerging. Twitter squatting, a variant on cyber squatting (the practice of improperly registering Internet domain names using the trademarks or brand names of others), occurs when a person registers a company or brand name as a Twitter username with the intent of profiting or causing confusion. Brands that have experienced Twitter squatting include Amazon.com, Apple and Pepsi. For many brands, their respective Twitter squatters have merely registered the user name and left the account idle. Other brands have not been so lucky.

It only takes an e-mail address to open a Twitter account, which makes it easy for someone to pose as a company spokesperson and post misleading, even scandalous, material. This happened to one prominent Fortune 500 company. A woman posing as a company employee opened a fake Twitter account under a user name which incorporated the company name. This woman answered questions about the direction of the company, where philanthropic resources were being spent, and even posted responses to questions about an infamous incident in the company's past. The company has since contacted Twitter, and asked that the user name be reserved for the company's sole use.

User name squatting is not limited to Twitter, and a business's strategy for protecting its trademarks from squatters should encompass all social networking sites, including popular sites such as Facebook and MySpace. Franchisors and franchisees must work together to protect the franchise's valuable marks. Four basic steps should be taken: (1) develop and enforce internal policies governing social networking; (2) register key trademarks and variants as user names with all relevant social networking sites; (3) continue to monitor social networking sites for unauthorized uses; and (4) if user name squatting is discovered, contact the social networking site and demand that the site end the squatting activity and reserve the user name only for the business itself.

Protecting the Brand: Recommended Actions

Development of Internal Policies

It is important to develop strict internal policies governing who may speak on behalf of the franchise company on social networking sites, and who has the right to register the company's name or trademark (and obvious variants thereof) as a user name on such sites. It is vital that a franchise company maintain control over who represents the company publicly, including any statements made about or allegedly on behalf of, the company on sites such as Twitter and Facebook. Franchisors may develop policies which permit individual franchisees to register the company's name or mark on a social networking site which promotes the franchisee's individual location, as franchisees may be best suited to address the needs of the customers in their communities. If the franchisor chooses to permit the franchisees to do so, it is important for the terms of

the franchise agreement and related policies to detail how the franchisor's marks may and may not be used on such sites. For example, design elements should be used in accordance with company standards regarding font, color and size. Franchisees, in turn, should ensure that all employees and team members comply with those policies.

Preemptive Registration

Companies should consider preemptively registering their company name and trademarks, and possible permutations of the name and mark, as user names on all relevant social networking sites in order to prevent squatters from registering the names first. Whether or not the business intends to use the accounts is, in large part, irrelevant. In most cases, registration of a user name is free, and the accounts may sit idle if the business does not wish to use them. However, it may be advisable for a franchisor to establish a Facebook or Twitter presence and build an online profile that represents the entire organization. Franchisors may then wish to encourage franchisees to utilize the Facebook page or Twitter account in compliance with the franchisor's policies governing social media.

Continued Monitoring

Following registration of the company name and trademarks, businesses should continue to monitor social networking sites in order to ensure that no unauthorized use of their company name or trademark is being made on these sites. Although hundreds of active social networking sites exist in the United States, on-line tools have been developed to streamline this monitoring process. Sites such as Usernamecheck.com and Namechk.com allow individuals and businesses to search many of the most popular social networking sites for user name availability. Any infringing use should be reported under the terms of use for the particular social networking site.

Franchisors should monitor any sites operated by franchisees or team members to ensure that trademarks are being used in compliance with the terms of the franchise agreement and that all of the policies related to use of social networking sites are also complied with. In addition, both franchisors and franchisees should monitor their social networking sites for inappropriate or offensive content. Franchisors and franchisees should also monitor the major social networking sites, including Facebook and Twitter, to determine what users are saying about their products and services, so that any negative comments can be addressed.

Conclusion

Social networking sites offer many new and exciting opportunities for franchisors to reach out to their customers and to promote their brands, while connecting with potential franchisees. These sites also provide a low-cost marketing alternative allowing franchisees to reach out to potential consumers within their communities. However, brand owners should be mindful of the risks as well as the rewards of social network marketing. With a few keystrokes third parties have the potential quickly to spread misinformation, cause confusion, and tarnish a company's hard-earned reputation. By establishing internal policies pertaining to social networking, preemptively registering all marks as user names, carefully monitoring sites for unauthorized use, and promptly taking action to address user name squatting under each site's terms of use, trademark owners can better protect their valuable trademarks.

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INSIDE THIS EDITION

[Message from the Chair](#)

[Lew Rudnick Award to John Baer](#)

[The ABA Forum is now on Facebook!](#)

[Community Service Event](#)

[How to Create Healthier Franchise Relationships and Happier Clients](#)

[Franchising and Social Network Marketing](#)

[Washington Ruling Raises Area Representative Disclosure Issues](#)

[New Books from the Forum on Franchising](#)

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Washington Ruling Raises Area Representative Disclosure Issues

By: David L. Cahn and Jeffrey S. Fabian

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Many franchisors use two- and three-tiered, multi-unit expansion models to develop their franchise systems. In turn, the relationships between the various parties involved in these models raise questions as to whether they are subject to the requirements of the Federal Trade Commission (FTC) Franchise Rule ("FTC Rule") and the various state franchise registration and disclosure laws. Depending on the rights and duties a franchisor grants to a franchisee under a particular multi-unit expansion model, the franchisee may: (1) have no disclosure or registration obligations; (2) be subject to disclosure in the franchisor's Franchise Disclosure Document ("FDD"); or (3) be required to prepare its own FDD, separate and apart from that of the franchisor, or prepare a "joint FDD" with the franchisor. Further complicating the issue, franchise laws in certain states have not yet been revised or clarified to adhere to the FTC's position on the issue. As with all disclosure violations, failure to adequately and properly disclose all parties involved in the franchise sales process, including intermediate parties, can lead to civil liability, fines and mandatory rescission offers.

Franchisees involved in multi-unit expansion typically fall into one of three classes. First, the term "area developer" is often used to describe a class of franchisees who are granted the right to open more than one franchise in a defined territory in accordance with a development schedule. Area developers are not intermediate parties, but rather are unit franchisees who are granted additional rights (and are subject to additional obligations) to open multiple units. The second class of franchisees is commonly referred to as "area representatives" or "development agents." These third parties act essentially as brokers for the franchisor in exchange for a percentage of the initial franchise fee and royalties paid by franchisees they recruit, and in many situations perform some post-sale obligations on the franchisor's behalf. However, area representatives do not enter into franchise agreements or other agreements with franchisees, and the area representative's direct contractual rights and liabilities reside with the franchisor. The third class of franchisees is generally referred to as "master franchisees" or "subfranchisors." For the most part, these terms describe franchisees who recruit and enter into subfranchise agreements directly with "subfranchisees," and pay fees to the franchisor out of the amounts they collect from their subfranchisees. Master franchises are commonly used for international expansion, though they may be used domestically as well. (The plethora of terms used above demonstrates the need for the franchising industry to agree on standard terms of such intermediaries.)

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A recent case still pending in the Washington State court system demonstrates the complexities and obscurity surrounding the registration and disclosure obligations of franchisees involved in a franchisor's multi-unit expansion efforts, and how the definitions of these parties can be interpreted broadly. *Pinchin v. Nick-N-Willy's Franchise Pizza Company, LLC*, Bus. Fran. Guide (CCH) ¶ 14,179 (Wash. Ct. App., Jul. 22, 2009) involves a franchisee's claim for rescission of its franchise agreement, based upon the franchisor's failure to disclose its relationship with the area representative who "played a role" in recruiting the franchisee into the Nick-N-Willy's system. The franchisor's FDD did not reference the area representative, and the area representative did not prepare its own FDD. While the intermediate party involved in the case is actually referred to as an "area developer" by the parties and in the decision, the term "area representative" is used to describe the party in this article because it is more consistent with the definitions described above and with industry practice. In other words, while the parties entered into an Area Developer Marketing Agreement, the rights and obligations described in that document are more akin to those of an area representative than an area developer. For example, the intermediate party at issue was responsible for recruiting, screening and interviewing prospective franchisees, and promised the franchisor that it would provide training and support services to franchisees in its geographic territory, but the franchise agreement was entered into exclusively between Nick-N-Willy's and the franchisee. Nonetheless, the trial court determined that the area representative was required to register as a "subfranchisor" with the Washington Securities Division. Accordingly, its failure to register constituted a violation of the Washington Franchise Investment Protection Act, and in addition the franchisor's failure to disclose information about the area representative in its FDD violated that same statute. As a result, the trial court granted the franchisee partial summary judgment, and awarded them the right to rescind their franchise agreement.

Prior to the trial court determining the amount of the franchisee's monetary judgment, Nick-N-Willy's and the area representative filed an interlocutory motion in the Washington Court of Appeals seeking discretionary review of the trial court's grant of rescission. The Court of Appeals denied the motion, citing Nick-N-Willy's and the area representative's failure to meet the "heavy burden" of satisfying the standard for discretionary review. As a result, the trial on the franchisee's claim for damages will go forward, and Nick-N-Willy's and the area representative must wait until a final judgment is entered before appealing the lower court's decisions.

Under the FTC Rule only "subfranchisors" must prepare their own FDDs. To be considered a subfranchisor under the FTC Rule, a party must have, "(1) the authority to enter into a franchise agreement (or another agreement relating to the franchise), and (2) as a result of entering into such an agreement, that party is obligated to perform after the purchase of the franchise is consummated." Amended Franchise Rule FAQ's (FAQ #9). If either of these two elements is absent, the party should not be deemed a subfranchisor under the FTC Rule. An area representative is not a subfranchisor, "unless that person is a party to the franchise agreement (or to another agreement involved in the franchise)." *Id.* (emphasis in original). Therefore, it appears that the area representative relationship in Nick-N-Willy's is not a subfranchise under the FTC Rule.

However, in certain states, area representatives may fall within the definition of "subfranchisors" even though they do not fit that definition under the FTC Rule. In particular, Hawaii and Illinois appear to continue to treat area representatives as subfranchisors. Washington also appears to do so based on the Court of Appeals' ruling in the Nick-N-Willy's case. Maryland's definition of a "subfranchisor," also leaves the issue open to interpretation, by stating that a subfranchisor includes any party to whom the right is granted, "to sell or negotiate the sale of franchises in the name of or for the franchisor." Md. Bus. Reg. Code Ann. §§ 14-201(c) and 14-201(i) (emphasis added). This definition is substantially similar to that in the majority of franchise registration states, specifically: California, Hawaii, Illinois, Minnesota, New York, North Dakota, Rhode Island, South Dakota (statute uses the term "arranges" rather than "negotiates"), Washington and Wisconsin. The Illinois Franchise Disclosure Act also retains the "or negotiate" component in its subfranchisor definition despite recent amendments. The Washington trial court pinned its decision on the "or negotiate" language in this definition, and found that this disjunctive clause allows a party to act as a subfranchisor without actually selling a franchise or entering into an agreement with the franchisee.

California previously followed the approach taken by the trial court in the Nick-N-Willy's case; however, in 2008, the California Department of Corporations abandoned this position in favor of the FTC's new stance. In expressly adhering to the FTC's approach, California's current position is that, "[t]o be a subfranchisor, a development agent must have the authority to enter into a franchise agreement; i.e., be a party to the franchise agreement, and as a result of entering into the agreement, be obligated to perform franchise obligations;" and that, "[p]erformance of post-sale obligations required by the franchise agreement, without more, does not make a development agent a subfranchisor." Franchisors, Subfranchisors and Development Agents, Ca. Dept. of Corporations Release No. 18-F at 3 (Feb. 1, 2008) (emphasis in original).

So, once a party's role and relationship is determined, what are its disclosure obligations?

As noted above, the answer for area developers is easy, because they have no disclosure obligations. Franchisors with area developers must identify the area developers as franchisees in Item 20, but they may not identify area developers separate and apart from the list of individual unit franchisees.

Master franchisees clearly meet the definition of a "subfranchisor" on the federal level and under all state franchise registration and disclosure laws. As discussed above, in certain states area representatives may also meet this definition. Subfranchisors must prepare their own FDDs, and all franchisors must properly disclose their subfranchisors in their FDDs. The subfranchisors' and the franchisor's FDDs (or the parties' joint FDD) must, at a minimum, include: Item 1 through Item 4 disclosures for both parties; separate Item 20 tables for each subfranchisor and the entire franchise system; and, financial statements for both parties in Item 21.

For area representatives, under the FTC Rule, there are no disclosure obligations. However, a franchisor who contracts with area representatives must include disclosures in its FDD sufficient to put prospective franchisees on notice of the existence of the franchisor's area representatives, and of the services that the area representatives will perform on behalf of the franchisor. Under the FTC Rule, this information should be provided in Item 1 of the franchisor's FDD. In addition, if the area representative will have management responsibility relating to the sale or operation of franchises, it must be disclosed in Items 2, 3, and 4, and if it will have an active role training then disclosure in Item 11 may also be necessary. However, the authors have been informed by one state franchise examiner at the Maryland Attorney General's Office that area representatives who do not qualify as subfranchisors may only be identified in the list of franchisees included as an exhibit to the FDD.

Therefore, under the FTC Rule, it is unlikely that the area representative in the Nick-N-Willy's case was obligated to prepare its own FDD. However, it seems reasonably clear that Nick-N-Willy's was obligated to disclose its relationship with the area representative in its FDD. In addition, ambiguities existing under the Washington Franchise Investment Protection Act arguably suggest that the area representative was obligated to prepare its own FDD. At a minimum, it appears that franchisors will be well served to include Item 2, 3 and 4 disclosures regarding area representatives in state-specific versions of their FDDs for Washington. In addition, until the law is more settled on this issue, area representatives in Washington, as well as in other states, like Hawaii, Illinois and Maryland, whose laws contain similar "subfranchisor" definitions, should consider preparing their own separate FDDs or joint FDDs with their franchisors. While the Nick-N-Willy's case is yet to be finally resolved, the proceedings to date appear to be a warning shot directed at franchisors and area representatives who fail—even in good faith—to disclose their relationship to prospective franchisees. In states like Washington where the definition of a "subfranchisor" is arguably broader than the definition under the FTC Rule, these parties may face additional registration and disclosure obligations.

From a public policy point of view, requiring state-specific disclosures concerning area representatives seems consistent with the goals of federal and state franchise sales regulation. However, the uncertainty concerning whether such area representatives are required to register as franchisors does not appear consistent with

such policy objectives, given the recent issuance of the revised FTC Rule and other attempts to harmonize franchise sales requirements on a national basis. Accordingly, one can only hope that NASAA and the franchise registration states will follow California in taking steps to clarify the intent and reach of their subfranchisor regulations.

[Back to Top](#)

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INSIDE THIS EDITION

[Message from the Chair](#)

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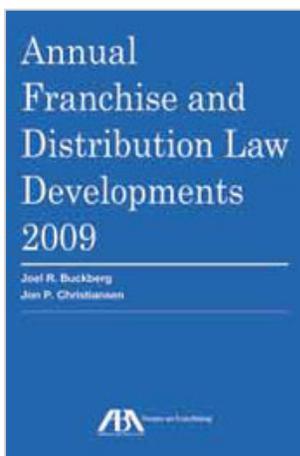
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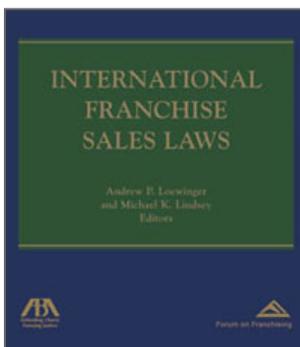
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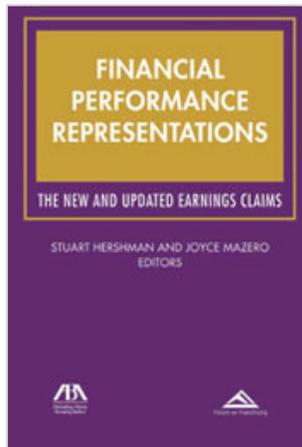
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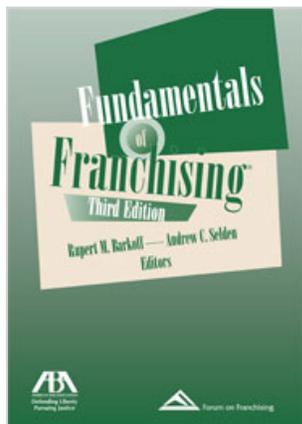
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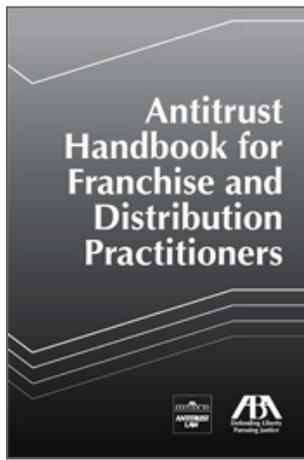
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