



# FAIR FRANCHISING STANDARDS

American Association of Franchisees & Dealers

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# FOREWORD TO FRANCHISING STANDARDS MILLENNIUM EDITION: AND ONWARD INTO THE 21ST CENTURY

By Richard L. Rosen, Esq.  
Chair, Fair Franchising Standards Committee  
August 2002

Almost eight years have passed since a group of some 40 leaders of the franchise community, including both franchisor and franchisee business executives and entrepreneurs, attorneys and franchise business consultants, met in Chicago with the avowed purpose of formulating and promulgating a set of standards by which franchisors and franchisees could be guided and which, hopefully, would “level the playing field” between their disparate interests.

Those of us who were present in Chicago undertook the project with a combination of enthusiasm and optimism but with a certain degree of skepticism as to whether this daunting project could be accomplished and if so, how it would be accepted by the industry.

Thanks to the unflagging efforts of Robert Purvin, Chairman of the AAFD, Keith Kanouse and Don Boroian, the initial Chairs of the committee, and the members of the committee, some of whom made their contributions over a two or three year “term” of service and a fewer number who have been there since the beginning, the Fair Franchising Standards have become a reality.

When I first became involved in the practice of franchise law over 30 years ago (in 1969 to be precise) the field was like the “wild west,” wide open and treacherous. Over that 30-year period, the field has become more regulated, both franchisors and franchisees have become more sophisticated and an enormous portion of our economic landscape is now encompassed by the franchising prairie. The evolution of business and legal issues in the franchise field has created an ongoing challenge for those of us who would provide fair and equitable standards by which the franchise community can guide itself. Who would have thought that once competing franchisors would be coexisting within common physical premises in a co-branded venture? Who would have imagined that consumers would be purchasing trademarked products from their desks with merely the stroke of a computer key? It has become evident that new and ever changing developments will provide ongoing challenges for leaders and visionaries in the franchise field as the 21st century unfolds before us.

While the members of the Fair Franchising Standards Committee undertook and accomplished their work with a fair minded and even handed approach, the Standards were not immediately accepted in all quarters. Recent experience indicates however, that an ever increasing number of the leaders on each side of the franchising table recognize that it is in their mutual best interests that a balance be struck between the legitimate business concerns of both franchisors and franchisees. Towards this end, the AAFD Fair Franchising Standards have sought to achieve such a level of equality.

As franchisees have become more sophisticated, as franchisee associations have become more prevalent, and as franchisors have recognized the fact that a spirit of communication and negotiation can have a positive influence on franchisor/franchisee interactions, franchisors and franchisees have become increasingly engaged in positive ongoing communications that have, inevitably, led to better franchisor franchisee relations.

With this background, the Fair Franchising Standards Committee will continue its work on completing those Standards which have not, as yet, been finalized, on finalizing the commentary, which sets forth differing views with respect to particular Standards, and by formulating a Model Franchise Agreement which will be consistent with the Fair Franchising Standards. For those of us who are still engaged in this task, the work remains both a challenge and an opportunity to leave a positive imprint on our field of dreams.

# AAFD FAIR FRANCHISING STANDARDS

## PREFACE

By Robert L. Purvin, Jr.,  
Chair, Board of Trustees, AAFD  
(April 1996)

It is with the greatest of pleasure and pride that I introduce the AAFD's Fair Franchising Standards. This year and a half effort is without question the most ambitious project ever attacked by our Association. More important, with the adoption of balanced standards for the franchising community, we are poised to enter a truly new Golden Era of franchising; a time when the long talked about level playing field in franchising will be a reality.

The AAFD's Fair Franchising Standards are assured a prominent role in defining franchise relationships into the future. Consistent with the AAFD's marketplace solutions to the problems facing the franchising community, the AAFD's Fair Franchising Standards will serve as the basis for accrediting forward thinking franchisors who recognize that endorsement of their franchising practices by the AAFD can pay enormous dividends in the franchising marketplace.

I am especially proud of the fine men and women who have served long and hard to make these standards a reality. More than forty dedicated individuals, representing franchisors, franchisees, and distinguished members of the franchise legal bar have invested hundreds of hours in achieving a negotiated, balanced, fair set of standards that will serve franchising's best interests.

To Keith Kanouse who chaired the vital Fair Franchising Standards Committee, should go the greatest of accolades. As the history of franchising is written, Keith should surely be placed high among the heroes. Keith is an attorney in sole practice whose bread, so to speak, has historically been buttered by his able representation of franchisors. So Keith's dedication of time and effort in spearheading this monumental task included enormous financial risk, beyond the substantial hours devoted to producing a dramatic statement on how franchisors and franchisees should work with each other into the future.

Don Boroian's Francorp provided generous underwriting this important project, and hosted all of the Committee's 'in person' meetings. Don also led the franchisor committee, providing a constant spirit of fairness, and an uncommon desire to leave his mark on the franchising community as a better place than when he entered it.

Franchisors and franchisees, through independent franchisee associations, will have the opportunity to reap the benefits of AAFD accreditation by agreeing to abide by the AAFD Fair Franchising Standards, as a matter of contract. The good sense of the members of our Fair Franchising Standards Committee was to produce standards through a process of negotiation, involving franchisors, franchisees, and legal professionals all intent on achieving fairness and balance. They have done their jobs better than anyone could have ever expected.

In one sense, however, this job was not as monumental as had been assumed at the beginning. Many of us expected that "getting to yes" within the often contentious environment of the franchising community would prove nearly impossible. To our surprise and delight, the Committee almost always 'got to yes,' and more easily than any of us could have imagined. Having required a two-thirds vote on each standard, and requiring each standard to have majority support from our groups of franchisors, franchisees and attorneys, we worried we had created an insurmountable obstacle to success.

But we misjudged what can be accomplished by fair minded people who appreciate that good business agreements are negotiated by parties who want to do business with one another, and who appreciate that the best business deals are the ones that are 'win-win.' Much to our surprise and delight, and although we had our debates and sometimes we could not get consensus, for the most part, our standards were very easy to draft. "Getting to yes" proved easy, because this Committee recognized just how much we all had to 'Win!'

# FOREWORD

By Keith J. Kanouse, Esq.  
Chair, Fair Franchising Standards Committee  
(April 1996)

“A top in balance spins effortlessly - A top not in balance wobbles, if it spins at all.” K.J.K.

Having been involved in franchising for 22 years, I have witnessed and participated in the maturation of franchising and certain franchise systems. This process of maturation and saturation has created a new set of problems and challenges for franchising including encroachment and cannibalization, branding and co-branding, alternative methods of distribution, non-traditional franchises, nonrenewable and acquisition of competitive systems, to name a few.

As an attorney (primarily representing franchisors), I, too, have been guilty of “over-lawyering” in drafting one-sided franchise agreements in favor of my franchisor clients. In recent years, my practice has increasingly gravitated toward representing prospective franchisees, existing franchisees and franchisee associations. Being on the “other side of the table” has sensitized me in the inequities that exist in the franchisor/franchisee relationship reflected in the “standard” franchise agreement. The increasing friction and litigation between franchisors and franchisees, in part caused by an inequitable franchise agreement, have not been good for the franchise community.

Franchisees, who have historically been under-represented and isolated, are gathering together to protect their interests. Through the creation and effectiveness of national franchisee associations, like the AAFD, franchisees and prospective franchisees have become more sophisticated and aware of the problems, which exist in the franchise community. In response, the International Franchise Association, which for over 30 years represented solely the interests of franchisors, has now opened its membership to franchisees. With increasing frequency, franchise attorneys are “coming out of the closet” in their interest and willingness to represent franchisees and franchisee trade groups. State laws regulating the franchisor-franchisee relationship have passed in Iowa and have been proposed in many other states. Congressman John LaFalce’s federal franchise legislation has been proposed in the last three legislative sessions of the U.S. Congress. More and more franchise systems are seeing the advent of independent franchisee associations within their system.

In this rapidly changing (and improving) environment the AAFD is to be commended for its forward thinking philosophy of providing marketplace solutions (rather than litigation or legislation) to problems in the franchise community. Bob Purvin, Chairman of the AAFD, determined that national standards for the franchise community, to serve as the basis for providing accreditation to fair thinking franchisors, were appropriate and necessary. I was pleased and very honored to have been asked to serve as Chair of the AAFD Fair Franchising Standards Committee.

It was the good sense of the members of the Committee, which I applauded as Chair, to insist the Committee have a “balanced” composition of franchisors, franchisees, consultants and attorneys, so that all perspectives would be advanced and discussed. We wanted the work product of the Committee to be consistent with our mission -- to develop standards which reflect and balance the legitimate business interests of a franchisor and the legitimate business interests of its franchisees -- and not be considered “going from the existing extreme to the other.”

Although some within the franchisor community will no doubt take issue with our first adopted Standards (as well as some zealous franchisee advocates for opposite reasons), I am very pleased with the initial outcome of the Committee’s efforts. The lively, frank and extensive discussion by all members of the Committee allowed

our franchisor representatives to better understand the franchisee's perspective, and vice-versa, allowing consensus to be achieved, surprisingly, on most issues. In my opinion, the work of the Committee will accomplish more to improve the franchisor / franchisee relationship and the state of franchising, than any legislation or litigation has accomplished over the past 30 years.

The AAFD Fair Franchising Standards do not constitute a document "etched in stone." This document is meant to be fluid continually attempting to balance the legitimate business interests of franchisors and franchisees. Some Standards considered by the Committee have been tabled, as consensus could not be achieved. Other Standards have yet to be addressed. I would expect that these Standards will be modified and supplemented, as I envision that our promulgation of these Standards will evoke much discussion and review. This interplay will be good for franchising. The more dialogue between franchisors and franchisees, the greater the understanding of each other's perspective, which should result in less friction in the relationship.

This work represents "one giant step" for this Committee, the AAFD and the franchise community. But it is just the first step. The Commentary presented represents only the initial drafts of the various subcommittees, and has yet to be approved by the Committee of the whole. Over the next year, the Committee intends to complete the adoption of Standards and finalize the Commentary. Thereafter, the Committee intends to adopt Model Franchise Agreement language, where appropriate, suitable to implement the various Standards, and consistent with the Standards and the Commentary. This is a time consuming but extremely worthwhile task. I know our Committee members will accomplish these goals with the same enthusiasm they exhibited in creating these Standards.

Finally, I would like to thank Bob Purvin for his vision and for offering me the opportunity to chair the Committee. The Committee is further indebted to my Co-Chair, Don Boroian (one of the foremost leaders in franchising for the past many years) for his generosity in providing the Committee the facilities to complete its tasks. Most of all, I gratefully acknowledge and thank each and every one of our very knowledgeable and talented Committee members for their tremendous time and effort. No matter what a Committee member's perspective, one thing is clear - each member wants to protect and foster franchising into the 21st Century. This is one committee that has accomplished something historic and meaningful.

Keith J. Kanouse

# MISSION STATEMENT

The mission of the FAIR FRANCHISING STANDARDS Committee of the American Association of Franchisees and Dealers is to develop standards relating to various business and legal aspects of the franchisor/franchisee relationship so that a more equitable franchise agreement becomes the standard for the franchise community which reflects and balances the legitimate business interests of the franchisor and the legitimate business interests of its franchisees.

## **THE COMMITTEE:**

The Fair Franchising Standards Committee was empowered by resolution of the AAFD's Trade Association Council to draft Fair Franchising Standards, which will provide the basis for objective accreditation of franchising companies seeking the endorsement of the Association. Although the Committee was initially composed of franchisees and attorneys with a bent toward franchisee representation, the Committee immediately determined, with the approval of the Trade Association Council, to include franchisors and franchisor legal counsel and consultants who shared the conviction that the franchise community needs a viable and balanced code of standards to define fair franchising practices.

The Committee has included more than 50 members, fairly balanced between franchisor perspectives and franchisee perspectives. About a third of the Committee members are attorneys who have provided substantial guidance in drafting and legal consistency. The Committee was originally divided into 8 subcommittees, and each subcommittee had responsibility to draft proposed standards for two broad categories of franchise relationship subjects. Each subcommittee was composed of at least one participant providing a franchisor's perspective, at least one participant providing a franchisee's perspective and at least one participant providing a legal perspective. The current Committee of 21 and the members' respective affiliations are set forth on page XI.

## **THE PROCESS:**

Keith Kanouse (a lawyer) served as Chair, and Bob Purvin (a franchisee representative) and Don Boroian (a franchisor representative) each served as co-chairs, and the three "chairs" constituted the executive committee. With Mr. Kanouse taking the laboring oar, the executive committee divided the franchise relationship into 16 subject areas, and created 8 subcommittees to take on drafting proposed standards for two subject areas each. Once the subcommittees completed their process of drafting proposed standards and commentary, the Committee of the whole began a series of in-person meetings and weekly conference calls to debate and adopt each proposed standard, one by one.

It is significant to appreciate that, early on, the Committee decided it must achieve a quorum of at least 3 participants from each perspective in order to take action on any standard. All in-person meetings and most conference calls had substantially greater participation. Moreover, in order to adopt a standard without anyone feeling their viewpoint had been "railroaded," the Committee required each standard to have a majority approval from each perspective, and a two-thirds majority vote of the whole Committee for ultimate adoption. Even with these stringent standards for approval, the Committee was able to achieve consensus on most issues. The resulting set of Standards presented to the AAFD House of Delegates for approval, have the solid endorsement of the Fair Franchising Standards Committee of the whole.

The Committee has a three-year plan and goal to fully implement the AAFD's Fair Franchising Standards. The first year's goal has been to adopt these Standards. This goal has been substantially completed, although there are several standards that require further debate to achieve consensus. Standards that have not yet been acted on or approved by the Committee are set forth in italics and language that has been rejected have been tabled and referred by to committee for further review. Of course, as a living code, the AAFD Standards will always be subject to amendment, augmentation and elaboration.

The Committee's second goal is to complete adoption of remaining proposed standards, draft a glossary of franchising terms, and to develop and approve commentary to aid in the interpretation of the Committee's intent and purposes in adopting each standard. This 2000 edition achieves some of these objectives with final completion expected in 2001. Final commentary will encompass both majority and minority views. Some subcommittees have offered preliminary commentary, some more elaborate than others, with their initial drafts of proposed standards. The Committee has decided to include this proposed commentary, in unapproved and unedited form, to augment the interpretation of the Standards. However, readers are advised that the proposed commentary, *and all materials reported in italics*, have not been approved by the Committee, nor has the proposed commentary been edited to correspond with the final Standards as adopted.

The Committee's third goal is to provide model language for a franchise agreement that would comply with the AAFD Fair Franchising Standards as well as a model *Fair Franchise Agreement approved by the American Association of Franchisees and Dealers*.

## FAIR FRANCHISING STANDARDS COMMITTEE MEMBERS AMERICAN ASSOCIATION OF FRANCHISEES & DEALERS

As of November, 2000, the Committee composed of 15 individuals, divided into 3 groups, 5 franchisor representatives (franchisors and consultants), 5 franchisee representatives and 5 attorneys, who have the right to vote on the adoption of Standards, Commentary and Model Language. An affirmative vote of 2/3 of the members of each of the 3 groups present at a meeting is required to adopt or amend Standards, Commentary and Model Language.

The current members of the Committee are:

Attorneys	Franchisor Representatives	Franchisee Representatives
Richard Rosen, Chair Robert L. Purvin, Jr. Warren Lewis Mario Herman Justin Klein	Timothy Galfas Ted Pearce, Meineke Mufflers Roy Flora, US Franchise Systems Michael Ferretti, Great Harvest Bread Co. Phil Purcell, Dynamic Management	Peter Hanson, Huntington Learning Laura Lee Blake, AAHOA Gary Robins, Supercuts "CK" Chandrakant I. Patel
<b>Past Members:</b> Keith J. Kanouse, Past Chair Seth Stadfeld Harold Brown John Allan Perry Nissler Gary Persian A.J. Barr Edward Linden Thomas Bailey Robert Einhorn Carmen Caruso Harris Chernow David Holmes Steven Kelley Michael Webster Michael Hanks	<b>Past Members:</b> Mark Siebert Don Boroian Roy Ruppert Scott Baker Robert Kushell Howard Bassuk Dennis Galloway Robert Muir Don Karlin Mike Leven Joshua Richman Greg Helwig Cynthia Gartman, Motel 6 John Kujawa, McDonalds Ira Young, Tutor Time Child Care David Omholt, Entrepreneur Authority	<b>Past Members:</b> Carl Unger Larry Oberly Randy Dupuis Jack Overton William Wheeler Michael O'Kash John Crowley Ron Soto Eileen Fox Bruce Wallisch Tommy Damigella Robert Volpe John Crowley Robert Lewis Tom Hanson Mark Zuckerman Jim Karnath Victor Pierce Gary Grace Cathy Thomas Chris Schmitz

# CHAPTER 1.

## Accreditation

### **STANDARD 1.0 GENERAL STANDARD**

These Fair Franchising Standards are adopted by the American Association of Franchisees and Dealers to serve as the basis for fair and balanced franchise relationships, and for the further purpose of providing standards for the accreditation of franchisors whose franchising practices are in conformity with the principles embodied in these Standards.

### **STANDARD 1.1 CRITERIA FOR EARNING THE AAFD FAIR FRANCHISING SEAL**

A franchisor may qualify for the AAFD FAIR FRANCHISING SEAL if it meets all of the following criteria:

1. The franchisor recognizes an independent association of the franchise owners in its franchise system. The AAFD will deem an association or franchisee advisory council to be an independent franchisee association if it is a Trademark chapter of the AAFD, or if its board of directors or equivalent certifies to the AAFD that the association has the right to adopt its own bylaws, elect its own board and delegates, establish its own agenda and meet on its own schedule, and has the resources and opportunity to work to accomplish its agenda;
2. The franchisor and the independent franchisee association each certifies to the AAFD that the franchisor's franchising practices and then current franchise agreement is consistent with the spirit of these Standards, and the AAFD's Standards Committee concurs in this finding;
3. The franchise agreement either has been negotiated with, or recommended by, the independent franchisee association;
4. The franchise agreement and franchising practices of the franchisor have been ratified by the franchisees in the system through an independent survey of the franchisees in which all franchise owners are invited to participate and at least 75% of all franchisees actually participate, and 75% of the participants vote that they:
  - a. Are reasonably "satisfied" with their franchise agreement;
  - b. Are reasonably "satisfied" with their franchise relationship with the franchisor; and
  - c. Are in favor of the franchisor earning the AAFD's Fair Franchising Seal.

### **STANDARD 1.2 ACCREDITED CONTRACT STATUS**

A franchisor may receive AAFD Accredited Contract Status for its franchise agreement as the first step in the

process of earning the Fair Franchising Seal upon a finding by the Association's Committee on Standards and Accreditation that its currently offered franchise agreement substantially conforms with these Standards and further agrees to comply with the remaining provisions of Standard 1.1 as soon as reasonably practical, and not later than its third anniversary of receiving Accredited Contract Status from the AAFD.

*(Amended on 09/22/08; 12 in favor, 1 opposed, 0 abstention – formerly Standard 1.7, which now replaces former Standard 1.2) .*

### **STANDARDS 1.3: ADMINISTRATIVE FEES AND CHARGES**

The AAFD may establish such fees and charges to be assessed franchise systems which apply for accreditation as are approved by the AAFD Board of Directors and reasonable and appropriate to offset the administrative expense of processing the application, evaluating candidates and completing the accreditation procedure.

### **STANDARD 1.4 BENEFITS OF THE FAIR FRANCHISING SEAL**

A franchisor that has satisfied the Fair Franchising Seal requirements shall be eligible to market and use the Fair Franchising Seal in accordance with the AAFD's approved license agreement, which shall include the use of approved graphics and certifications. A Seal recipient that becomes a Supporting Member of the AAFD shall be entitled to market, through the AAFD, its franchise program to the general public and to AAFD members. A Seal recipient shall have any other privileges, benefits and obligations as may be contained in the license agreement, and such other privileges and benefits as may be authorized from time to time by the AAFD Board of Directors.

*(Amended 9/22/08 - 13 in favor, 0 opposed, 0 abstentions)*

### **STANDARD 1.5 BENEFITS OF ACCREDITED CONTRACT STATUS**

A franchisor whose current franchise agreement has earned AAFD Accredited Contract status shall be eligible to market and use such accreditation in accordance with the AAFD's approved license agreement for AAFD Accredited Contract recipients, which shall include the use of approved graphics and certifications. An Accredited Contract recipient who becomes a supporting member of the AAFD shall be entitled to market, through the AAFD, such accreditation to the general public and to AAFD members. An Accredited Contract recipient shall have any other privileges, benefits and obligations as may be contained in the license agreement, and such other privileges and benefits as may be authorized from time to time by the AAFD Board of Directors.

*(Amended 9/22/08 - 13 in favor, 0 opposed, 0 abstentions)*

**Commentary:** Proposed by Subcommittee. The AAFD's purpose is to place AAFD accredited franchisors on a pedestal in the franchising marketplace and to drive more and more franchising companies to seek AAFD Accreditation as a marketing mechanism. The AAFD will make marketing opportunities available solely to AAFD Accredited Franchisors (Four or Five Star Level). In the future, AAFD Accredited Franchisors will be publicized and marketed by a variety of methods, including Co-op Advertising, and AAFD sponsored and promoted Trade Shows, limited to accredited franchisors.

### **STANDARD 1.6 TERM AND RENEWAL**

The term of accreditation for AAFD Accredited Contract status is set forth in Standard 1.2 and is intended to serve as an interim process towards earning the AAFD Fair Franchising Seal. The AAFD Fair Franchising Seal is valid for a 3-year period if all criteria are continuously met. In either case, the term of AAFD recognition may be reasonably extended by the AAFD to facilitate the certification or recertification process, as the case may be. During the term, the franchisor's franchise agreement and franchising practices must be consistent with these Standards. The Fair Franchising Seal may be renewed by meeting the criteria as may exist as of the date of renewal.

*(Amended on 09/22/08; 12 in favor, 0 opposed, 1 abstentions)*

**Commentary:** Generally, accreditation of a collectively bargained franchise agreement should be valid for the contract term of the franchise agreement, subject to re-certification of the franchisee satisfaction survey every three years.

### **STANDARD 1.7 TERMINATION**

If at any time during the term of accreditation the AAFD, acting on its own or petitioned by an affected franchisee association, determines that there has been a material negative change in the franchise agreement or franchise relationship, the AAFD may act to decertify, suspend or withdraw accreditation of any accredited franchise system. Upon expiration of the accreditation term, or if accreditation has been decertified, suspended or withdrawn, the franchise system may requalify in order to renew or reinstate accreditation. Accreditation may be renewed by meeting the criteria for accreditation as may exist as of the date of renewal. Upon expiration of accreditation, or upon termination, the affected franchise system must immediately cease holding itself out as AAFD Accredited in any form, and must cease using the AAFD logo and seal in its franchise system marketing, or for any purpose whatsoever.

### **STANDARD 1.8 CONFIDENTIALITY**

Pending approval, the AAFD will keep confidential among its Board of Directors and Standards and Accreditation Committee all of the franchisor's information, the existence of its accreditation application and the status of its accreditation application.

### **STANDARD 1.9 FAIR FRANCHISING SEAL DISCLOSURE**

Fair Franchising Seal recipients shall make the following written disclosure which must be prominently published on the recipient's main franchise marketing website, and other websites that the AAFD may reasonably require, and also be provided to each prospective franchisee at the time of delivery of the Franchisor's Franchise Disclosure Document:

The AAFD Fair Franchising Seal is awarded to companies by the vote of their franchise owners or independent dealers that they are satisfied with their franchise agreement and franchise relationship, and upon certification by the AAFD's Standards Committee that the franchise system operates in a manner consistent with the spirit of the AAFD's Fair Franchising Standards. The AAFD does not examine or evaluate the viability of a franchisor's business model. The AAFD Fair Franchising Seal is not an endorsement of the business model, nor is it an assurance or guarantee that any franchisee will be successful in the operation of the franchised business.

*(Amended 9/22/08; 12 in favor, 0 opposed, 0 abstentions and further amended on May 1, 2009 by a vote of 11-0-0)*

### **STANDARD 1.10 ACCREDITED CONTRACT DISCLOSURE**

A franchisor that has earned AAFD Accredited Contract Status shall make the following written disclosure which must be prominently published on the recipient's main franchise marketing website, and other websites that the AAFD may reasonably require, and also be provided to a prospective franchisee at the time of delivery of the franchisor's disclosure document:

The franchise agreement in our franchise disclosure document earned AAFD Accredited Contract Status as of \_\_/\_\_/\_\_\_\_.

AAFD Accredited Contract Status is awarded to companies that have not yet qualified for the AAFD Fair Franchising Seal, but that have adopted and offer franchise agreements that have been determined by the AAFD to substantially conform to the AAFD's Fair Franchising Standards. The AAFD does not examine or evaluate the viability of a franchisor's business model. The accredita-

tion of the contract is not an endorsement by the AAFD of the business model or the franchisor's business practices, nor is it an assurance or guarantee that any franchisee will be successful in the operation of the franchised business.

An AAFD accredited contract recipient has up to three years from the date of accreditation to comply with the requirements necessary to earn the AAFD Fair Franchising Seal, which must include ratification by the system's independent franchisee association and its franchisees.

*(Amended 9/22/08; 12 in favor, 0 opposed, 0 abstentions and further amended on May 1, 2009 by a vote of 11-0-0)*

# CHAPTER 2.

## Mutuality of Rights and Equity

### STANDARD 2.0 GENERAL STANDARD

A franchise agreement should grant a franchisee the right, subject to stated obligations, to own and operate a business in a defined market or territory under the franchisor's trade name, trademarks, and trade dress and in conformity with the franchisor's business and marketing system as it may exist from time to time. A franchise relationship should be based upon mutual respect and recognition among the franchisor and its franchisees of the respective rights and interests of one another, as those rights and interests may be expressed in a franchise agreement that conforms to these Standards, or that has been negotiated on a system-wide basis taking into account these Standards.

**Commentary:**<sup>1</sup> A fundamental precept upon which the franchise relationship should be based is that of mutuality of rights and obligations. These standards seek to discourage franchise agreements that are one-sided contracts of adhesion, which grant few rights and impose significant obligations on the franchisee while retaining significant rights for the franchisor and minimizing the franchisor's obligations owed to the franchisee. The general standard recognizes that the franchise agreement should incorporate rights and obligations of both parties and that many rights and obligations under the franchise agreement should be mutual.

### STANDARD 2.1 FRANCHISOR'S OWNERSHIP RIGHTS

Subject to these Standards, a franchisor should be recognized to own those proprietary assets as are set forth in the franchise agreement, including the franchisor's intellectual properties and the goodwill of the franchise system that derives from and is associated with the trade name, trade marks and trade dress of the system.

**Commentary:** This Standard recognizes the ownership interest of the franchisor in the elements of the franchise system that the franchisor brings to the relationship. All viable franchise systems are based upon some proprietary asset such as a recognized product, trade secret, trade name or the like.

### STANDARD 2.2 FRANCHISEE'S OWNERSHIP RIGHTS

Subject to these Standards, a franchisee should be recognized to own a substantial equity interest in the fran-

1. Note: All Standards and Commentary, and other materials presented in *italics* are **proposed language** of a subcommittee and have not been officially endorsed by the entire Committee, or the AAFD.

chised business as set forth in the franchise agreement, including the local goodwill of the franchised business which is derived from the franchisee's personal attention to the business with the investment of time, money and effort, and which is to be distinguished from the goodwill in the system owned by the franchisor.

**Commentary:** The AAFD Standards generally, and Standards 2.1 and 2.2 in particular, take into account that both the franchisor and franchisee have a significant interest for all their respective contributions in creating and building the franchise system. The franchisor owns the goodwill associated with the trademark and the system. The franchisee owns the local goodwill that is built up from the franchisee's investment of capital, time, ingenuity and labor to make the local business succeed as reflected in the resale price of its business. It should also be recognized that, for as long as a franchisee remains in the system, the franchisee will be responsible for the management of the franchised business.

A franchisor should recognize a franchisee's right to sell the franchised business at fair market value or transfer the business to any franchisor-approved entity in accordance with Chapter 11 of these Standards. As noted in Standard 11.3, the franchisor should have a right of first purchase, rather than a right of first refusal.

### **STANDARD 2.3 INDEPENDENT CONTRACTOR**

Where a franchise agreement creates an independent contractor relationship, both the franchisor and franchisee should act in a manner consistent with the legal standards of an independent contractor relationship.

**Commentary:** The law relating to independent contractors generally provides for the limiting of liability of one party in exchange for a surrender of control over the other party. As applied to franchising, while a franchisee is responsible for the operation of the franchised business as an independent contractor, a franchisor should limit its involvement in the franchisee's exercise of independent business judgments. A franchisor should provide a franchisee with system standards and with adequate training and guidance (including written procedures, sample or required disclaimers, sample or required warranties, etc.). As an illustration, while a franchisor cannot hire or fire a franchisee's employees, a franchisor may be justified in requiring a franchisee to follow the franchisor's hiring guidelines if the nature of the franchised business dictates (e.g., a criminal background check if the employee will be working with children).

*(Adopted September 14, 2006 by a vote of 11-1-0)*

### **STANDARD 2.4 RIGHT OF ASSOCIATION**

A franchisor should recognize and avoid interference with a franchisee's right to freely associate and participate in an independent franchisee association.

**Commentary:** Franchisees who try to associate in groups should not be subject to retaliatory action. This Standard recognizes that a franchisor should act in good faith in its dealings with an independent franchisee association. Given the disparity in bargaining power inherent in the franchise relationship, group association is a primary method by which franchisees can effectively voice their concerns to their franchisor. The First Amendment of the Constitution constitutionally guarantees all United States citizens the rights of free speech and peaceful assembly.

There should not be any retribution against a franchisee for association activities including the activities referenced above as well as all operating matters. This includes such matters as inspection, auditing, and allocation of scarce materials, advertising, and resolution of disputes. However, a franchisor may, in the normal course of business, exercise its rights so long as they are not used to circumvent the franchisee's right of free association.

### **STANDARD 2.5 RIGHT TO USE FRANCHISORS TRADE NAME**

A franchisee association that represents a majority of franchise owners and units of a franchise system has

the right to use the franchisor's trade name in the title of the association.

**Commentary:** At the very least, franchisees who form an independent association that represents a majority of franchisees in the system ought to be able to identify that association with their franchise system in a purely descriptive and non-derogatory fashion. All franchise agreements permit use of the franchisor's trade name in connection with the operation of their businesses. Since the right of free association exists to help equalize the inequality of bargaining power in the franchise relationship, it is logical and appropriate to allow franchisees to use the franchisor's trade name in their association to identify that organization to their fellow franchisees. Other than the association's use of the franchisor's trade name as part of the association's name, all other use of the franchisor's trade name is subject to the franchisor's consent.

## **STANDARD 2.6 RIGHT TO ASSOCIATE WITH OTHER ASSOCIATIONS**

The franchisee association may enroll in a larger association that may encompass other associations.

**Commentary:** The franchisee's right of association should include the opportunity to participate in other organizations which may be dedicated to the furtherance of franchise interests.

## **STANDARD 2.7 RIGHT TO JOINTLY NEGOTIATE**

Upon the request of either party, both a franchisor and an independent franchisee association representing a majority of franchisees in the system will agree to collectively negotiate solutions to problems, opportunities and agreements between the parties.

**Commentary:** Application of collective negotiation to the franchise relationship is not only convenient, but a most effective way to equalize the disparate positions of the franchisor and franchisee and efficiently resolve issues before they become disputes. Moreover, joint negotiation allows all parties to gain a sense of investment in a resulting agreement, and affords the opportunity to achieve an agreed upon uniformity in franchise systems and relationships.

*(Adopted September 14, 2006 by a vote of 13-0-0)*

## **STANDARD 2.8 RIGHT TO AIR GRIEVANCES**

Both the franchisor and the franchisees of a franchise system should have the right to air grievances on all issues (on both an individual and group basis) without suffering negative repercussions. The system should adopt a jointly endorsed grievance procedure.

**Commentary:** This standard suggests an alternative to traditional dispute resolution which should exist to prevent grievances from becoming disputes. If the parties to a franchise agreement are confident in their ability to openly discuss problems encountered in the operation of the franchise system, grievances should be resolved by mutual agreement before they become disputes. In this context, it is not just franchisees who fear retaliation. Franchisors are often wary of action by franchisees if there is open discussion of system wide difficulties. Both parties should be free to discuss important issues without suffering repercussions for doing so.

## **STANDARD 2.9 DISCRIMINATION AMONG FRANCHISEES**

A franchisor should not arbitrarily engage in disparate treatment among similarly situated franchisees operating under similar financial and marketing conditions.

**Commentary:** This Standard addresses an issue that arises when a franchisor treats franchisees in its franchise system differently. Diverse geographic markets and a number of other factors may sometimes justify

a franchisor's different treatment of its franchisees. The question is whether the disparate treatment of similarly situated franchisees under similar financial and marketing conditions is unfair. Prevailing legal standards for measuring unfairness in this context are based in statutory and common law notions of arbitrariness. The standard therefore proscribes discriminatory acts encompassing arbitrariness by a franchisor that leads to unfair treatment of a franchisee.

#### **STANDARD 2.10 UNFORESEEN CHANGES**

When events occur that may result in fundamental changes to the franchise system, or which have the likelihood of materially impacting that system, provided that it does not violate any applicable law, regulation or any third party agreement, then the franchisor should meet with representative members of the franchise system, including representatives of the system's franchisee associations, in a timely manner to discuss these changes or events and to explore the effects upon the franchise system and how these changes can or should be addressed.

# CHAPTER 3.

## Territorial Rights

### STANDARD 3.1 REASONABLE MARKET PROTECTION

A franchisee has the right to reasonable market protection.

**Commentary:** Consistent with Standard 5.1, a franchise agreement should provide for a market opportunity, including multiple avenues to its market, sufficient to provide the franchisee with a fair and adequate return on his or her investment. When negotiating market protection and a franchisee's territorial rights, the parties should deal with each other fairly and in good faith. Subject to standard 3.2 and its commentary below, in providing a franchisee with reasonable market protection, a franchisor should avoid adversely impacting the franchisee's market or cannibalizing the franchisee's sales such that a fair and adequate return is jeopardized.

*(Adopted September 14, 2006 by a vote of 11-1-1)*

### STANDARD 3.2 FRANCHISORS RIGHT TO MAXIMIZE MARKET SHARE

Subject to Standard 3.1, a franchisor has the right to create and secure its market share/presence for the benefit of the system as a whole.

**Commentary:** When a franchisor wants to expand the system in a defined market, it should notify all franchisees who may be materially affected by the proposed expansion and engage in a collaborative process to address the needs of the market and the parties.

The franchisor should have in place and should communicate to its franchisees policies, both with respect to market expansion generally and regarding the impact that such market expansion may have on specific franchise businesses.

In determining whether to open or authorize the opening of an additional unit in close proximity to an existing franchised business, or otherwise penetrate the franchisee's market, a franchisor should consider all reasonably relevant criteria, including but not limited to the following:

1. The characteristics of the market, including, but not limited to, demographics, competitive environment and geographic considerations.
2. The ability of the existing franchised business to adequately serve the market.

3. The impact of the expansion on the existing customer base.
4. The terms of the existing franchisee's franchise agreement.
5. Whether or not the franchised business would be harmed or benefited by the proposed expansion.
6. The impact of the proposed location or other market penetration on the franchisee's existing business.

A franchisor should develop a procedure for resolving market expansion issues which will provide any franchisee whose business might be impacted by the proposed market expansion with the opportunity to express its position regarding the proposed expansion. The resolution procedure should consider whether the expansion should take place and/or if a franchisee should be compensated for any loss it may experience, and a method for calculating compensation for the loss.

*(Adopted May 3, 2006 by unanimous vote)*

# CHAPTER 4.

## Intellectual Property

### STANDARD 4.0 GENERAL STANDARD

A franchisor is responsible for developing, maintaining, protecting, policing and enforcing the trademarks, copyrights, patents, trade dress, confidential information and trade secrets associated with the franchise system for the benefit of the franchise system.

**Commentary:** [to be drafted]

### STANDARD 4.1 TRADEMARK OWNERSHIP

A franchisor should own or control the licensing of all trademarks associated with the franchise system to the extent that such trademarks relate to the franchise system's business and geographic areas of operation. A franchisee should receive reasonable consideration for a trademark adopted by a franchisor which the franchisee creates and in which the franchisee makes a substantial investment.

*(Adopted October 23, 2000 by a vote of 9-0-1)*

**Commentary:** *Proposed by subcommittee (not adopted): Strong federally registered trademarks are extremely important elements in any regional or national franchise system. The franchisor, as the creator of a franchise system, generally is the owner of all or most trademarks associated with the system. Franchisees generally invest in a business in the system on the assumption that the franchisor will be reasonably diligent in maintaining and protecting existing trademarks and in developing new trademarks to keep the system fresh and competitive, and that the franchisor will not require franchisees to make unreasonably frequent or expensive trademark changes.*

*The franchisor should be responsible for the cost of defending its trademarks and opposing infringers, but it also should have the flexibility to settle disputes and require trademark changes to avoid excessively expensive or risky litigation, or to minimize or eliminate conflicts with other trademark owners.*

*Sometimes when a new franchisor is formed, it will license the primary trademark for its franchise system from an individual, or from a parent or affiliated company. This type of arrangement creates several risks: that the trademark owner may terminate the franchisor's license, causing franchisees to be required to cease using the trademark before their franchises expire; that the trademark owner may not maintain or protect the trademark; and that franchisees will have no legal remedies (or will have severely limited legal remedies) if the trademark owner goes into bankruptcy. Any license involved in this type of arrangement should be structured to reduce these risks to the extent feasible.*

*Sometimes franchisees will come up with ideas for new trademarks, and will even invest time and money in taking new trademarks beyond the idea stage. Generally, those new trademarks should be regarded as the franchisor's property, subject to the franchisee receiving some reasonable consideration from the franchisor based on the franchisee's return on his or her investment, so that the franchisor can make the new trademarks available to all franchisees at no or little cost to them (excluding necessary costs for items such as new signs, displays or advertisements). Presumably, this is one of the benefits of being in a franchise system -- to share in the creativity of the franchisor and other franchisees. In some cases, however, new trademarks should be regarded as the franchisee's property, such as when they involve a high degree of creativity or are peripheral to the franchise system, or when the franchisee makes substantial investments in their development. A franchisee's independent development of a line of private brand name products related to the franchise system would be an example of this type of situation.*

## **STANDARD 4.2 COPYRIGHT OWNERSHIP**

A franchisor should own all copyrights associated with the franchise system, except that a franchisee should own a copyright that it creates and in which it makes a substantial investment.

**Commentary:** *Proposed by subcommittee (not adopted): Frequently, the operation of a regional or national franchise system involves the use of copyrighted materials. The franchisor, as the creator of a franchise system, generally is the owner of all or most copyrighted materials associated with the system. Franchisees in a franchise system generally assume, and rightfully should be entitled to assume, that the franchisor will be reasonably diligent in maintaining, policing, protecting and enforcing its rights in existing copyrighted materials and that the franchisor will not require franchisees to make unreasonably frequent or expensive changes to comply with a franchisor's modifications to such materials.*

*The franchisor should be responsible for the cost of defending its copyrights and opposing infringes, but it also should have the flexibility to settle disputes and to avoid excessively expensive or risky litigation, or to minimize or eliminate conflicts with other copyright owners. However, franchisees should be responsible for the cost and the burden of policing and defending copyrights which they have developed and registered.*

*Given ever-increasing technological advances and the expansion of copyright filings with the U.S. Copyright Office, the cost of complying with filing requirements, and the costs associated with enforcing and investigating potential copyright rights and infringements can be extensive. The franchisor should bear the burden to complete all necessary copyright filings and to protect all rights in said copyrights.*

*Sometimes franchisees will invest time and money in creating new copyrightable materials. Generally, those new copyrights should be regarded as the franchisee's property, but the franchisor should have the right of first refusal to purchase them and the option to license their use, for some reasonable consideration based on the franchisee's return on his or her investment, to make the new copyrights available to all franchisees at no or little cost to them.*

*Presumably, one of the benefits of being in a franchise system is to share in the creativity of the franchisor and other franchisees. In some cases, however, new copyrights should be regarded as the franchisee's property, such as when they involve a high degree of creativity or are peripheral to the franchise system, or when franchisees make substantial investments in their development as is the case with the creation of new computer programs and/or software. In this regard, a franchisee's independent development of copyrightable materials could be analyzed under the federal Work for Hire Doctrine Standards.*

## **STANDARD 4.3 PATENT OWNERSHIP**

A franchisor should own all patents associated with the franchise system, except that a franchisee should own a patent which it creates and in which it makes a substantial investment, subject to the franchisor's right of first refusal to purchase the patent and the franchisor's right to license such patent, for reasonable consideration, for use by all franchisees in the system.

**Commentary:** *Proposed by subcommittee (not adopted): An invention which is federally registered in the U.S. can provide significant financial and competitive advantages to all franchisees in any regional or national system for the duration of the patent and may even serve as one of the bases for the creation of the franchise system. The franchisor generally is the owner of all or most patents associated with the system.*

*Franchisees, in consideration for their financial investment, should be entitled to rely on the franchisors reasonable diligence in maintaining, policing and enforcing its rights in existing patents, in developing new patents, if possible, to keep the system innovative and competitive, and in anticipating the known expiration of a patent monopoly and the ultimate dedication of an invention to the public for unrestricted use. Franchisors should not, however, require franchisees to make unreasonably frequent or expensive changes related to the use of the franchisor's patents.*

*The franchisor should be responsible for the cost of patent prosecution, as well as defending, policing and investigating its patents and opposing infringers, but it should also have the flexibility to settle disputes and to require changes related to the issuance of other related patents or to the known expiration of its existing patents. Given the limited statutory monopoly rights or years of protection conveyed to patent owners, all of which are publicly known to franchisees, the costs associated with changing technology, operations and systems related to the expiration of existing patents should be borne by franchisors. However, franchisees should be responsible for the cost and burden of policing and defending patents which they have developed and registered.*

*Sometimes franchisees will invest time and money in creating and prosecuting novel and non-obvious patentable inventions. Generally, those new patents should be regarded as the franchisees' property, but the franchisor should have the right of first refusal to purchase, and the option to license the use of, the same, for some reasonable consideration based on the franchisee's return of its investment, to make the new patents available to all franchisees.*

*Presumably, one of the benefits of being in a franchise system is to share in the creativity of the franchisor and other franchisees. In some cases, however, new patents should be regarded as the franchisee's property, such as when they involve a high degree of creativity or are peripheral to the franchise system, or when franchisees make substantial investments in the research and development of such inventions. In this regard, a franchisee's independent development of patentable materials could be analyzed under the federal Work for Hire Doctrine Standards.*

#### **STANDARD 4.4 TRADE DRESS OWNERSHIP**

A franchisor should own all trade dress associated with the franchise system to the extent such trade dress relates to the franchise system's business and geographic areas of operation. A franchisee should receive reasonable consideration for trade dress adopted by the franchisor that the franchisee creates and in which the franchisee makes a substantial investment.

*(Adopted October 23, 2000 by a vote of 9-0-1)*

**Commentary:** [to be drafted]

#### **STANDARD 4.5 CONFIDENTIAL INFORMATION, TRADE SECRET OWNERSHIP AND CUSTOMER LISTS**

A franchisor generally owns all confidential information and trade secrets associated with the franchise system. A franchisee has an ownership interest in confidential information and trade secrets it develops, or developed, prior to or during the franchise relationship, subject to all of the following:

1. The information is implemented with the approval of the franchisor;
2. The information is subject to the franchisors joint ownership rights;
3. With the exception of customer lists developed in whole or in part by the franchisee, the franchisor has the right to disseminate the information throughout the franchise system;

4. Both the franchisee and the franchisor have the right to use the jointly owned information upon the termination of the franchise; and
5. Neither the franchisor nor any franchisee may divulge the information without the approval of the other, and with reasonable consideration, except within the franchise system.

*(Adopted October 23, 2000 by a vote of 8-1)*

**Commentary:** *Proposed by subcommittee (not adopted): Confidential information such as operational procedures and methods, company manuals, and trade secrets are fundamental components in any regional or national franchise system. The franchisor, as the creator of a franchise system, generally is the owner of all or most confidential information and trade secrets associated with the system. Franchisees generally invest in a business in the system on the assumption that the franchisor will be reasonably diligent in maintaining, policing, protecting and enforcing its rights in existing confidential information and trade secrets and in developing new confidential information and trade secrets to keep the system fresh and competitive, and that the franchisor will not require franchisees to make unreasonably frequent or expensive changes to comply with confidential information or trade secret regulations.*

*The franchisor should be responsible for the cost of defending its confidential information and trade secrets and opposing infringers, but it also should have flexibility to settle disputes and to avoid excessively expensive or risky litigation, or to minimize or eliminate conflicts with others with whom they might have disputes. However, franchisees should be responsible for the cost and the burden of policing and defending confidential information and trade secrets that they have developed.*

*Sometimes franchisees will invest substantial time and money in creating new confidential information and/or trade secrets. Generally, this information should be regarded as the franchisee's property, but the franchisor should have the option to consider the use of the same, for some reasonable consideration based on the franchisee's return of his or her investment, to make the new confidential information or trade secrets available to all franchisees.*

*Presumably one of the benefits of being in a franchise system is to share in the creativity of the franchisor and other franchisees.*

#### **Other Issues to Consider:**

*[Standards of care -- prospective franchisees, franchisees, physical security, computer transmission, Internet, franchise association use, etc.]*

*[Franchisors use of confidential information in other businesses or franchise systems/potential or actual harm to a franchise system.]*

*[Need for reasonable definition of "confidential information" (information not in public domain/definition should not be overreaching/state law issues/fair to franchisor to say that its state's trade secret law applies, subject to any overriding law in the franchisee's locality)/burden on franchisee to prove that information is not "confidential"]*

### **STANDARD 4.6 PROTECTION OF CONFIDENTIAL INFORMATION AND TRADE SECRETS**

Franchisees are responsible for using reasonable efforts to protect all confidential information and trade secrets associated with the franchise system.

**Commentary:** *Proposed by subcommittee (not adopted): See Commentary to Standard 4.5*

### **STANDARD 4.7 COSTS OF TRADEMARK MODIFICATION**

A franchisor is responsible for all costs related to changing a trademark, including costs of signage, stationery and items bearing the discontinued proprietary marks, if the change is due to the need to cease an infringement of a senior user's trademark, the franchisor's negligence or a radical change in direction in the franchise

system unilaterally caused or mandated by the franchisor. Subject to Standard 6.5, a franchisee is responsible for the costs of changing a trademark in the franchisee's business, if a change is due to the continuing need to modernize the franchise system.

**Commentary:** *Proposed by subcommittee (not adopted): See Commentary to Standard 4.1*

#### **STANDARD 4.8 COSTS OF PATENT MODIFICATIONS**

A franchisor is responsible for the costs of changing the franchisee's use of a patent if the change is due to the franchisor's negligence or a radical change of direction in the franchise system unilaterally caused or mandated by the franchisor. Consistent with Standard 6.5, the franchisee is responsible for the costs associated with modifying the operation of the franchisee's business with regard to the use of the patent, if such a change arises out of the continuing need to modernize the franchise system or the expiration of the patent term.

**Commentary:** *Proposed by subcommittee (not adopted): See Commentary to Standard 4.2*

#### **STANDARD 4.9 COSTS OF TRADE DRESS MODIFICATIONS**

A franchisor is responsible for the costs of changing trade dress if the change is due to the need to cease an infringement of a senior user's trade dress, franchisor's negligence, or a radical change in direction in the franchise system unilaterally caused or mandated by the franchisor. Subject to Standard 6.5, a franchisee is responsible for the costs of changing trade dress of the franchisee's business, if a change is due to the continuing need to modernize the franchise system.

**Commentary:** *Proposed by subcommittee (not adopted): Changing the trade dress of a business generally involves a substantial investment that needs to be justified by an anticipated reasonable return on investment. For this reason, there should be reasonable limits on the amounts franchisees are required to invest in trade dress changes. Those limits generally should be defined by a combination of factors including, for example, timing (e.g., timing in relationship to initial investment, expiration of the franchise term or renewal of the franchise term; flexible timing based on market conditions or a franchisee's financial condition), frequency, and magnitude (e.g., minimum periodic investments; caps based on percentages of gross sales).*

*Franchisors often require franchisees to update their businesses' trade dresses to then-current Standards as a condition for renewing franchises. If renewals occur at reasonable intervals (for example, every 5 or 10 years) and if substantial trade dress changes are not required between renewals, this type of renewal condition may be a reasonable way of limiting the timing and frequency of trade dress changes, but still requiring changes to be made to keep franchised businesses fresh and competitive. If trade dress changes are required on renewal, their magnitude should be reasonably limited.*

*The franchisor should be responsible for policing franchisees' compliance with trade dress Standards. Those Standards should give franchisees some flexibility to be responsive to their own tastes or local tastes, but should be strict enough to cause businesses in a system to project a sufficiently consistent image.*

#### **STANDARD 4.10 PROTECTION OF COMPUTER SOFTWARE AND INFORMATION TECHNOLOGY**

A franchisor's proprietary software or information technology is entitled to protection as confidential information.

*(Adopted October 23, 2000 by a vote of 9-0)*

**Commentary:** *Proposed by subcommittee (not adopted): Sometimes franchisees will make substantial investments in the development of new computer software or information technology related to a franchise system. This software or information technology should be regarded as the franchisee's property, although the franchisee could be required to license the software or information technology exclusively to other franchisees in the system (directly or indirectly*

*through the franchisor) on reasonable terms, and could be prohibited, subject to reasonable conditions, from licensing the software or technology to competitors or other franchise systems.*

#### **STANDARD 4.11 DUTIES REGARDING COMPUTER SOFTWARE, INFORMATION TECHNOLOGY AND SYSTEMS DEVELOPMENTS**

Provided that a franchisor requires its franchisees to use its proprietary software, a franchisor should use good faith efforts to keep abreast of industry computer software and information technology and systems developments, and to inform its franchisees of those developments. A franchisor should inform its franchisees of these enhancements and developments and should (if economically practical) implement such changes as would be mutually beneficial to both the franchisor and its franchisees.

*(Unanimously approved 04 28 00, and amended October 23, 2000)*

**Commentary:** [to be drafted]

#### **STANDARD 4.12 COSTS OF COMPUTER SOFTWARE AND INFORMATION TECHNOLOGY MODIFICATIONS**

A franchisor has the right to require franchisees to use its proprietary software or information technology (if any), subject to the franchisor's good faith efforts to update the software or information technology and to keep the costs reasonable. Subject to Standard 6.5, franchisees are responsible for the cost of acquiring, maintaining and updating necessary proprietary or non-proprietary computer software and information technology to keep the franchise system competitive.

*(Unanimously approved April 28, 2000)*

**Commentary:** *Proposed by subcommittee (not adopted): If the franchisor requires its franchisees to use its proprietary software or information technology, it should be required to be reasonably diligent in staying abreast and implementing new software and information technology developments in its industry, and in reacting to those developments in a reasonable and prompt manner.*

#### **STANDARD 4.13 ANTI-DILUTION OF INTELLECTUAL PROPERTY**

A franchisor is responsible for protecting the value of all intellectual property associated with the franchise system. The franchisor either should not permit the intellectual property to be used outside of the franchise system or should permit the intellectual property to be used outside of the system only in ways that do not significantly dilute the intellectual property's value within the franchise system.

*(Adopted October 23, 2000 by a vote of 9-0)*

**Commentary:** [to be drafted]

# CHAPTER 5.

## Term and Renewal

### STANDARD 5.0 GENERAL STANDARD

Consistent with a franchisee's equity in the franchised business, a franchise agreement should have a reasonable initial term and renewal provisions.

**Commentary:** [to be drafted]

### STANDARD 5.1 INITIAL TERM

The initial term of the franchise agreement should be of sufficient length for a franchisee to reasonably amortize the initial investment to achieve an adequate and fair return on investment.

**Commentary:** [to be drafted]

### STANDARD 5.2 RENEWAL OPTIONS

A franchisee, at its option, should have the right to renew the franchise agreement for unlimited successive periods of time.

**Commentary:** The committee fully endorses the standard that a franchisee should have evergreen rights to renew a franchise, provided that the franchisee meets its reasonable contractual conditions for renewal (Standard 5.3). The initial term of the franchise agreement and its renewal periods should be adequate to give a franchisee the opportunity to achieve a reasonable return on its investment and must be sufficient to give a franchisee the further opportunity to build and realize the equity in the franchised business. Chris Schmitz moved, Lou Manganiello seconded, 12-0 approved, on 5-1-07.

### STANDARD 5.3 FRANCHISORS CONDITIONS FOR RENEWAL

A franchisor may impose reasonable conditions for renewal including notice and signing the franchisor's then current form of franchise agreement, provided the then-current form of franchise agreement has been collectively negotiated.

**Commentary:** *Proposed by subcommittee (not adopted): If a franchisee has "evergreen" renewal rights (see Standard 5.2) and has an option to go independent without being subject to a post term covenant not to compete (see Standard 13.1), a franchisor may impose reasonable conditions for renewal including reasonable notice of the exercise*

*of the right to renew and the signing of the franchisor's then current form of franchise agreement being signed by the newest franchisees within the system. The Subcommittee recognizes that this form of franchise agreement may be materially different from the franchisee's existing franchise agreement including possibly a higher royalty and/or advertising contribution and smaller protected or exclusive territory. It is important for a franchisor to be able to adapt to necessary changes in demographic, technology, methods of operation, new products and services, changes in laws, etc. Hopefully, the marketplace will control the degree to which a franchisor can materially change the terms of its franchise agreement. If the franchise agreement is subject to collective bargaining (see Standard 2.2), it should be deemed reasonable in its changes.*

*Unreasonable conditions for renewal would include:*

- 1. The payment of a renewal fee.*
- 2. The requirement that the franchisee sign a general release in favor of the franchisor (see Standard 16.3).*
- 3. Excessive upgrade requirements (see Standard 6.5).*
- 4. Material changes to the business terms of the relationship.*

# CHAPTER 6.

## Fees and Payments

### STANDARD 6.0 GENERAL STANDARD

A franchisor is entitled to charge reasonable fees for the initial and ongoing products, services and rights it provides its franchisees. Franchisees are entitled to get fair value for the fees paid to a franchisor.

**Commentary:** [to be drafted]

### STANDARD 6.1 INITIAL FRANCHISE FEE

An initial franchise fee should be structured to compensate a franchisor for providing services necessary to the opening of the franchisee's business and to have a stake in the success of a franchisee and encourage a franchisee to follow the franchise system.

**Commentary:** *Proposed by subcommittee (not adopted): An initial franchise fee is not fully earned by a franchisor until a franchisee is opened for business. A portion of the initial franchise fee should be escrowed with a third party. When a franchisee opens for business, a franchisor is paid the balance of the initial franchise fee. If a franchisee never opens for business, the escrowed portion of the initial franchise fee should be returned to the franchisee.*

*The initial franchise fee should be sufficient to cover a franchisor's expenses associated with the sale of a franchise and a period of time thereafter until franchisee is paying full service fees.*

### STANDARD 6.2 CONTINUING FEES

Continuing fees (royalties, service fees, etc.) should fairly reflect the value of services and rights provided by the franchisor to the franchisee.

**Commentary:** *Proposed by subcommittee (not adopted): Service (Royalty) fees are compensation to a franchisor for a franchisor's efforts in creating, maintaining and improving the franchise system. A franchisee should pay service fees promptly when due. A franchisor should design a service fee structure that makes it easy for a franchisee to pay service fees during the start-up phase of a franchisee's business.*

### STANDARD 6.3 LATE FEES

Both a franchisor and a franchisee should have the right to collect reasonable late fees and interest from each other for late payments to each other.

**Commentary:** Proposed by subcommittee (not adopted): Both a franchisor and a franchisee should be paid by each other when the money is due. Late payment fees should be set at a level sufficient to reimburse the party to whom the funds are owed for the time, trouble and expense of re-billing and collecting the late payment. Similarly, interest, reflecting the time and value of money, should be paid after a grace period by either party defaulting in the timely payment of its financial obligations.

## **STANDARD 6.4 PERSONAL GUARANTEES**

Personal guarantees of the franchisee's obligations to the franchisor can be appropriate in a franchise agreement when a franchisor looks to the ultimate performance from the principal(s) of the purchaser of the franchise. Guarantees should be subject to good faith negotiations between the parties and should fairly balance the needs of the franchisor and the franchisee.

*(Approved, June 6, 2002, by a vote of 12 to 1)*

**Commentary:** Proposed by subcommittee (not adopted): The committee believes that Personal Guarantees should be required only by the franchisee's primary principals and, when necessary to make such guarantees effective, their spouses.

## **STANDARD 6.5 EXPENSES FOR CAPITAL EXPENDITURES**

A franchisor should have the right to require its franchisees to periodically make capital expenditures, provided explicit frequency and cost limits are included in the franchise agreement and disclosed to the franchisee before the purchase of the franchise, and provided the expenditures are imposed on a system-wide basis and include company owned units.

**Commentary:** Proposed by subcommittee (not adopted): All systems change and need to be improved on a regular basis. Good business planning dictates that franchisors plan for change. Included in the plan should be periodic modifications and renovations. For example, if a franchisor requires a face-lift of the premises every 4 years, the best estimate of the cost of the face-lift should be provided in the FOC. Explicit details regarding the modifications should also be provided. If a franchisor fails to accurately disclose the extent, the cost and the time frame for periodic modifications or renovations of a franchisee's premises, then a franchisor should not be permitted to unilaterally require the renovations or modifications. A franchisor should include all such requirements in any financial or business plan offered to a franchisee.

# CHAPTER 7.

## Reporting Requirements

### STANDARD 7.0 GENERAL STANDARD

Reporting requirements should be designed to optimize the reciprocal flow of information between a franchisor and a franchisee, and among franchisees.

**Commentary:** *Proposed by subcommittee (not adopted): Reports submitted to a franchisor should be compiled and returned within a report to individual franchisees. For example, a P & L report submitted by a franchisee should result in a franchisee receiving a compiled P & L from a franchisor for all franchisees in the individual franchisee's market area; and a marketing report submitted by a franchisee should result in the generation of a compiled marketing report distributed to individual franchisees in the relevant market area.*

### STANDARD 7.1 FRANCHISOR'S RIGHT TO AUDIT

A franchisor should have the reasonable right to audit the relevant financial records of a franchisee.

**Commentary:** *Proposed by subcommittee (not adopted): A franchisee should be held accountable to a franchisor for monies due a franchisor. This is particularly true if the service (royalty) fee is a percentage of gross revenues. An independent confirmation of the accuracy of a franchisee's calculations of the amounts due a franchisor is good business practice. Audits of a franchisee should be limited in scope to the records of a franchisee reasonably necessary to verify amounts due a franchisor. All audits should be on notice, and paid for by the franchisor, unless there is a material discrepancy discovered in which case the cost of the audit should be borne by a franchisee.*

A franchisee should have the right to audit monies held by a franchisor on behalf of a franchisee, for example, in an advertising fund. (See Standard 10.1).

### STANDARD 7.2 CONFIDENTIALITY

Consistent with Standard 7.0, and subject to applicable law, franchisors and franchisees must respect each other's business needs to keep confidential the reported information provided in connection with their respective businesses. Nothing in this Standard should be construed to inhibit any party from addressing specific issues.

**Commentary:** *Proposed by subcommittee (not adopted): In order to encourage the free flow of information back and forth between a franchisor and its franchisees, franchisors and franchisees have a legal duty to each other not to disclose that information to third parties except as required by law or through judicial process. Mutual sanctions should*

*be developed, which are reciprocal in nature, for the disclosure by a franchisor or a franchisee of the other party's confidential information.*

### **STANDARD 7.3 CONFIDENTIALITY OF CUSTOMER LISTS**

In circumstances where parties to a franchise relationship have agreed to share customer lists, such customer lists should be maintained as confidential between the parties and neither a franchisor nor a franchisee should divulge or disclose such customer lists for any purpose without written or contractual consent, or unless otherwise required by law.

*(Standard Passed 12:3 Opposed (1 Zor/ 1 Zee/ 1 Atty) October 2, 2003)*

**Commentary:** Consistent with the duty of a Franchisor to utilize reported information for the benefit of the entire system (Standard 7.0), Standard 7.3 deals only with the confidentiality of customer lists, and not ownership rights, which are treated in Standard 4.5. Regardless of ownership rights, Standard 7.3 requires that customer lists be maintained as confidential and only may be divulged by a franchisor or franchisee upon the approval of the other, including provisions in the franchise agreement.

# CHAPTER 8.

## Obligations of Franchisors and Franchisees

### 8.1 SYSTEM UNIFORMITY

Generally, system uniformity is a characteristic of franchise systems. Where uniformity is part of the franchise system, a franchisor should have the right and the duty to enforce uniform system standards within the system's defined enforcement processes, for the benefit of the entire system and franchisees have the right to expect that such uniform system standards will be enforced by the franchisor. A franchise system should include collaboration with its independent franchisee association(s) as defined in these standards, to develop, monitor and evaluate system standards and enforcement processes.

*(Standard passed 12-0 in favor on October 17, 2005)*

**Commentary:** The success of franchising is, in significant part, based upon building a successful brand that drives market demand. Successful branding generally requires a uniform brand image, uniform product quality and service delivery. Franchisors should have the right to define and protect their brands, and should therefore have the right to establish and enforce uniform system standards to be maintained for the benefit of the system. System standards should evolve through a collaborative process which includes both the franchisor and its franchisees to keep the brand fresh and vibrant, as well as consistent. The committee recognizes that there are multiple cultures within the franchise community and that some franchise systems may encompass a more individualistic approach to their brand(s).

*(Commentary Passed 13-0 in favor, October 17, 2005)*

### 8.2 ABILITY TO ADDRESS UNIQUE MARKETS

Notwithstanding the general importance of maintaining system standards, a franchise system should have the flexibility to address specific market needs, unique markets and evolving market conditions and demands. Franchisees should have the opportunity to respond and adapt to their markets in a manner that is consistent with the image of the system branding and with the reasonable approval of their franchisor.

*(Standard passed 12-0 in favor, October 17, 2005)*

**Commentary:** Franchise systems should be flexible enough to adapt to specific markets and unique

environments, which may involve single or multiple units, as the case may be. This does not mean that franchisees should have license to deviate from system standards at will. A franchise system should adopt a collaborative process to evaluate market situations and characteristics which will facilitate adaptation to specific market environments.

*(Commentary Passed 12-0 in favor, October 17, 2005)*

### **STANDARD 8.3 FIXED CONTRACT OBLIGATIONS**

A franchisor should have clearly defined contractual obligations. *(Renumbered from Standard 8.1 on October 17, 2005)*

**Commentary:** *Proposed by subcommittee (not adopted): A franchisor's obligations should not be couched in discretionary terms (for example, "may" or "as the franchisor deems appropriate in its sole discretion"). A franchisor should be contractually obligated to physically service a franchisee at a franchisee's location, except in unusual circumstances. This obligation would change (and probably decline) as the relationship evolves. It should include:*

- 1. Pre start-up training sufficient to make a franchisee knowledgeable in all important aspects of the franchise operation so that a franchisee has a reasonable opportunity to succeed;*
- 2. A minimum on-premises obligation at start-up to make sure a franchisee implements the know-how/system properly; and*
- 3. Periodic service and supervision during the term as is reasonable and appropriate.*

### **STANDARD 8.4 CONTROLLED EXPANSION**

A franchisor should seek to grow (by opening new franchise or company-owned units) consistent with its capacity to provide meaningful service and support to all of its units. *(Renumbered from Standard 8.2 on October 17, 2005)*

**Commentary:** [to be drafted]

### **STANDARD 8.5 GOOD FAITH**

A franchisor and a franchisee should be obliged to deal with each other fairly, in good faith, with loyalty and with due care in the performance of their respective responsibilities. *(Renumbered from Standard 8.3 on October 17, 2005)*

**Commentary:** *Proposed by subcommittee (not adopted): There was discussion that franchisors should deal with franchisees in good faith but as businessmen at arms-length. Contrary to the normal fiduciary relationship, neither the franchisor nor the franchisees expect the franchisor to subvert their interests to those of the franchisee.*

### **STANDARD 8.6 FIDUCIARY OBLIGATION TO FRANCHISEES**

A franchisor owes a franchisee a fiduciary duty to the extent it handles a franchisee's funds for the benefit of a franchisee or the franchise system (as opposed to the franchisor's benefit). Otherwise, a franchisor owes a fiduciary duty to a franchisee only where a fiduciary relationship has been established by conduct as a matter of law. *(Renumbered from Standard 8.4 on October 17, 2005)*

**Commentary:** *Proposed by subcommittee (not adopted): There was discussion that except for a franchisor's handling of a franchisee's money, there is no intention on the part of franchisors to take on the obligations of a fiduciary as that term has been interpreted by courts over time. Franchisors expect to make a profit in their dealings with franchisees (in the form of royalty payments and initial fee payments). Also, there was discussion that the standard should not provide that there are no fiduciary obligations in the franchise relationship.*

## **STANDARD 8.7 QUALIFICATION OF FRANCHISEES**

A franchisor has the right and obligation to establish minimum criteria for suitable franchisee candidates and to apply these criteria to each prospective franchisee's qualifications as a suitable purchaser and operator of the franchise opportunity. *(Renumbered from Standard 8.5 on October 17, 2005)*

**Commentary:** [to be drafted]

## **STANDARD 8.8 TRAINING**

A franchisor has an obligation to provide initial and ongoing training in all relevant aspects of the franchise business sufficient to enable the franchisee to operate the business consistent with the system's standards. The franchisee should avail itself of such initial and ongoing training to achieve and maintain the ability to operate the business consistent with system standards.

*(Standard revised and adopted 18-0 with one abstention on October 5, 2004. Renumbered from Standard 8.6 on October 17, 2005)*

**Proposed Commentary:** *It is in the mutual interests of the franchisor and the franchisee for the franchisor to provide such initial and ongoing training as necessary to permit the franchisee to operate the business consistent with system and industry standards. For its own benefit as well as the benefit of the franchise system, the franchisee must avail itself of such training opportunities in order to achieve and maintain competence and professionalism in the business and industry.*

## **STANDARD 8.9 MANUALS AND OTHER TANGIBLE KNOW-HOW**

A franchisor has an obligation to furnish a franchisee with manuals and other tangible know-how in a usable format, which is updated as appropriate. *(Renumbered from Standard 8.7 on October 17, 2005)*

**Commentary:** [to be drafted]

## **8.10 SYSTEM ENHANCEMENTS**

A franchisor has a continuing obligation to make good faith efforts to enhance the system, taking into account competition and the mutual benefit of the franchisor and franchisees. *(Renumbered from Standard 8.8 on October 17, 2005)*

**Commentary:** *Proposed by subcommittee (not adopted): It was felt by some that the Standard should include an obligation to devote a certain percentage of franchisor resources to this obligation including investment in research and development. Others opined that both sides should take on responsibilities here. There was objection to any requirement that a specific percentage of resources be allocated to this requirement.*

## **STANDARD 8.11 COMMUNICATION AND INPUT**

A franchisor should develop and maintain a system of effective communication between the franchisor and the franchisees. *(Renumbered from Standard 8.9 on October 17, 2005)*

**Commentary:** [to be drafted]

# CHAPTER 9.

## Purchasing and Selling

### STANDARD 9.0 GENERAL STANDARD

A franchisor should seek to maximize the synergy and economies of scale associated with group purchasing to benefit its system at all levels.

**Commentary:** [to be drafted]

### STANDARD 9.1 STANDARDS AND SPECIFICATIONS

A franchisor has a right to establish purchasing standards and specifications.

**Commentary:** *Proposed by subcommittee (not adopted): There was discussion that the Standards should be set reasonably. This was minority view, however. It was felt that because the business operates under the franchisors trademark, it had the right to establish the Standards in its sole discretion.*

### STANDARD 9.2 ALTERNATE SUPPLIERS

Subject to the franchisors right to designate the suppliers of proprietary products and services, and the franchisors reasonable and good faith right of approval, a franchisee should have the right to purchase from any supplier who meets the franchisors reasonable and necessary standards and specifications.

**Commentary:** *Proposed by subcommittee (not adopted): It was discussed that suppliers should have a continuing obligation to meet a franchisor's reasonable and necessary standards as they may change from time to time. Also, a franchisor should approve a reasonable number of suppliers for competitive reasons.*

*It is acceptable for a franchisor to receive payments from suppliers based on purchases by franchisees but only if there is full and complete disclosure in advance to a franchisee.*

### STANDARD 9.3 RIGHT TO REASONABLE PROFIT/PRICING

Where a franchisor designates the source of supply for any products or services and the franchisor or an affiliate receives and discloses an economic benefit on the sale of such products and services, the franchisor is entitled to a reasonable profit on the sale of such products and the franchisee is entitled to a competitive

price which enables the franchisee to achieve a reasonable profit margin.

**Commentary:** [to be drafted]

#### **STANDARD 9.4 INSURABLE LIABILITIES**

The committee voted 11-4 with one abstention to subsume 9.4 into 19.4.

#### **STANDARD 9.5 MAXIMUM RESALE PRICES**

A franchise system should respect the right of each franchisee to establish appropriate product and service pricing within its individual market. In appropriate circumstances, a franchisor may establish a maximum resale price to be complied with by each franchisee in the system, provided that:

1. The franchisor applies the maximum resale price requirements to similarly situated units;
2. The actions of the franchisor and its franchisees comply with all applicable legal requirements;
3. The maximum resale price also applies to franchisor-owned units;
4. The franchisor takes into account the legitimate interests of franchisees, including (when legally permissible) soliciting in advance the opinions of franchisees as to the maximum resale price and any related promotion; and
5. The franchisor makes appropriate provision for franchisees and franchisor-owned units whose special circumstances cause them to be disproportionately negatively affected by the maximum resale price or any related promotion.

*(Adopted April 29, 2004. 12 in favor, 3 opposed. Franchisees vote 3 in favor and 2 opposed)*

# CHAPTER 10.

## Advertising

### STANDARD 10.0 GENERAL STANDARD

A franchisor should develop an effective marketing position and advertising strategy to increase brand awareness and maximize system sales.

**Commentary:** [to be drafted]

### STANDARD 10.1 USE OF ADVERTISING FUNDS

All monies in the advertising fund should be treated as trust funds and must be segregated and kept in a separate account from monies of a franchisor. All monies paid into a franchise system's advertising fund should be used for promoting the brand name of the products and services offered by the businesses in the system to the customers of the business, and reasonably related expenses necessary to protect the integrity of the fund. When a franchisor accepts monies from its franchisees, it is obligated to administer the fund equitably. These funds should not be treated as income to, or as an asset of, a franchisor.

**Commentary:** *Because of the obligation to manage the fund, a franchisor remains accountable to its franchisees for the use of and expenditures made from the advertising fund. The committee is split on whether a franchisor should have the right to charge the fund for its direct administrative costs associated with administering the fund, but the committee is in agreement that in no event should any charge be in excess of the franchisor's reasonable and direct costs. The existence and amount of any charges by the franchisor in administering the fund should be subject to specific negotiation between the franchisor and its franchisees. Monies from the advertising fund should not be used to fund franchise sales activities but may be used for media, production and marketing research. A franchisor should provide each franchisee an annual accounting of the fund at the fund's expense.*

*If a franchisor or any parent, subsidiary or affiliated entity of a franchisor operates similar businesses operating under the system and the marks (company-owned units), a franchisor and those related entities should make contributions to the advertising fund in the same proportion as franchisees are required to make.*

### STANDARD 10.2 INCLUSION OF FRANCHISEES IN DECISION-MAKING PROCESS

Advertising strategies and expenditures should include franchisees in the decision-making process.

**Commentary:** *Proposed by subcommittee (not adopted): A franchisor has the right to promote its system and the marks in order to protect the integrity of the marks. This needs to be balanced against a franchisee's need to have a voice in the type and content of advertising conducted. Particularly when a franchisee is required to advertise in its local market, a franchisee should have input into the advertising strategies and expenditures with a franchisor's guidance and approval.*

*Because the franchisees' own monies are contributed to the advertising fund, franchisees should have meaningful input as to how advertising dollars will be spent. A franchisor should establish procedures for soliciting franchisee input and establish a committee comprised of franchisor and franchisee representatives including representatives of any franchisee association or advisory council. The advertising fund can be used to cover the reasonable cost of research and development. In addition, franchisees should have a voice in establishing the principles for administration of the advertising fund and the use of the monies and have the right to review and debate proposed budgets and strategies whenever possible. Advertising expenditures from the fund should be used for the benefit of all businesses in the system (regardless of pricing strategies).*

### **STANDARD 10.3 LOCAL ADVERTISING**

If the franchise agreement requires a franchisee to advertise in its local market, a franchisor has the right to set reasonable standards and specifications for conducting this advertising, with input from a franchisee, and can require a franchisee to provide proof of the advertising conducted and the expenditures made.

**Commentary:** *Proposed by subcommittee (not adopted): Because a franchisor must protect its marks, it has an interest in ensuring that a franchisee is properly using the marks and portraying the business in a manner consistent with the image intended by a franchisor in a franchisee's advertising materials and activities.*

*When there are 2 or more franchisees in an advertising area ("ADI"), the franchisees should be encouraged to co-op funds to purchase and conduct local advertising. If franchisees co-op these advertising dollars, these expenditures should be credited against the franchisees' local advertising requirements and should not be in addition to such amounts. If the franchise agreement requires that the franchisee advertise in the Yellow Pages directory of its telephone company, the cost of the Yellow Page advertisement should be shared among all franchisees listed in the advertisement. This expenditure should be credited against the local advertising requirement as well.*

*When a franchisee is required to conduct a grand opening advertising campaign, the franchisee should provide proof to a franchisor that it has conducted the advertising and provide proof of expenditures.*

# CHAPTER 11.

## Transfer

### STANDARD 11.0 GENERAL STANDARD

Parties to a franchise agreement should have a reasonable right to transfer their interest in a franchise agreement.

**Commentary:** *Proposed by subcommittee (not adopted): A variety of issues must be addressed within the general question of "Right of Transfer." We will set forth below what we believe the key issues to be, some of the problems that might arise with respect thereto and our recommended approach as to each such item.*

### STANDARD 11.1 FRANCHISORS RIGHT TO TRANSFER

A franchisor has the right to transfer the system. The franchisor should exercise its right to transfer the franchise system responsibly, with due regard to the transferees ability and intent to support the system, and the transferee shall assume the obligations contained in the franchise agreements.

*(Standard was adopted on June 6, 2002, by a vote of 12-1)*

**Commentary:** *(Assignment to draft new commentary was assigned to subcommittee on June 6, 2002; the Committee voted unanimously to maintain existing commentary, adopted in 1996, for historical perspective): It is the unanimous sense of the Committee that franchisors have a duty to exercise their right to transfer the franchise system responsibly, with due regard to a transferee's ability and intent to support the system and honor all contractual commitments. There was little agreement on how to fairly codify this duty. There was substantial agreement that any transferee should covenant to assume all responsibilities under the proposed franchise agreement. The franchisee members of the committee seek a reasonable right to approve the proposed transferee, or a warranty or undertaking by the franchisor or its transferee that the transferee has the ability and intent to support the franchise system. The franchisor members adamantly objected to restricting the ability of a franchisor to transfer or assign the franchise agreement together with a franchisor's rights thereunder or to otherwise sell or transfer a franchisor's business. The franchisor members also unanimously objected to any warranty of the transferee's ability or intent to support the system.*

### STANDARD 11.2 FRANCHISEE'S RIGHT TO TRANSFER

A franchisee should have the reasonable right to sell or transfer his or her existing franchised business at fair market value, subject to the franchisors right to safeguard the integrity of the franchise system.

**Commentary:** [to be drafted]

## **STANDARD 11.3 FRANCHISORS RIGHT OF FIRST PURCHASE**

Subject to defined and limited conditions and exceptions, a franchisor should be afforded a “right of first purchase” rather than a “right of first refusal.”

**Commentary:** *Proposed by subcommittee (not adopted): Under this arrangement a franchisee, upon determining that he or she desires to sell the franchised business would approach a franchisor with specific price and terms and offer a franchisor the opportunity to purchase the franchised business. A franchisor would have a 30-day period within which it could accept or reject the proposed purchase at the designated price. If a franchisor rejects the opportunity to purchase, a franchisee would then have the right to offer the franchised business to third persons (either within or outside the franchise system) at or above the designated price. A franchisee’s ability to sell to third persons should be contingent on a contract, upon no less favorable price and terms, being entered into to sell the franchised business within 120 days of the date of the first offer to a franchisor, with a closing to take place within 60 days after the date of contract.*

*Should a franchisee wish to offer or sell the franchised business at lower price and/or other terms less favorable to him or her within the 120-day period, a franchisee must first give a franchisor a “right of first refusal” to purchase the business at the new price and terms. Upon receiving the new price and terms from a franchisee, a franchisor would be required to accept or reject such offer within 10 days of the date of receipt of the information by notifying a franchisee, in writing, of its decision.*

*There should be certain exceptions to these arrangements including:*

- 1. Transfers among existing partners or shareholders of the same franchisee;*
- 2. Transfers among existing related corporations, partnerships, limited liability companies or other entities within a franchisee network of the subject franchisee (assuming that a franchisee owns more than one franchised business);*
- 3. Transfers of less than a 50% interest in the entities referred to in (2.) above (cumulatively over an 18 month period);*
- 4. Transfers by a franchisee to entities in which a franchisee owns a majority of the equitable interest Transfers to a full time manager of the franchised business provided that the manager meets the reasonable requirements for approval by the franchisor applicable to franchisees generally;*
- 5. Transfers among family members including the spouse of a franchisee, a franchisee’s children, trust or his or her spouse or children;*
- 6. Transfers to the “next of kin” of a franchisee.*

*In all such cases, a franchisor must have a reasonable right of approval (but not a right of first refusal) of the transferee so that if the family member (or entity) is unable to meet a franchisor’s reasonable training and other requirements, then the transferee has the right to designate a full time general manager who could qualify to meet the requirements.*

*With respect to all transferee franchisees, either a franchisee or a manager approved by a franchisor must be actively engaged in the day-to-day management of a franchised business.*

## **STANDARD 11.4 ASSUMPTION OF EXISTING FRANCHISE AGREEMENT**

Upon any permitted transfer by a franchisee, the transferee should be permitted to assume the existing franchise agreement rather than be required to sign the franchisor’s then-current form of franchise agreement.

**Commentary:** [to be drafted]

## **STANDARD 11.5 TRANSFER FEE**

A franchisor should have the right to assess a reasonable transfer fee upon the transfer of the franchise by a

franchisee.

**Commentary:** *Proposed by subcommittee (not adopted): The transfer fee should be in the nature of a “cost recovery tool” such as training costs and legal costs and should not be a profit center for a franchisor (for example, a percentage of the gross sales price). The franchise agreement should attempt to set out the nature of the costs which are recoverable by virtue of the imposition of the transfer fee without necessarily tying the fee to an ‘accounting’ with respect to the costs. If a transfer is to a person or entity who or which is already a franchisee within the franchise system, then the transfer fee should be less than if the transfer is to someone who has to be evaluated and trained as a franchisee. Similarly, a lower cost structure should apply to a transfer to a general manager, store manager, partner or co-shareholder etc. of a franchisee.*

*In calculating or setting a transfer fee, it would be reasonable for a franchisor to take into account that its costs will change (probably increase) over time and some mechanism for the adjustment of the transfer fee as such costs changes could be utilized in the franchise agreement.*

## **STANDARD 11.6 FRANCHISORS REQUIREMENTS ON SALE OR TRANSFER**

A franchisor should have the right to establish and apply certain transfer criteria on a consistent, fair and reasonable basis.

**Commentary:** *Proposed by subcommittee (not adopted): A franchisor should have the right to apply its evaluation criteria with respect to the new proposed franchisee to ascertain whether the new proposed franchisee is an appropriate candidate for the franchise system. A franchisor should also have the right to evaluate, on a good faith, reasonable judgment basis, the economic viability of the transaction. In making an evaluation a franchisor should examine, not only the business deal, but also the criteria that focuses on the purchase by a specific transferee as opposed to the deal itself. For example, the individual may have substantial financial wherewithal and therefore a low return on his or her investment may be sufficient to meet his or her needs. Obviously, these issues can be troubling for a franchisor who wishes to prevent a new franchisee from undertaking onerous or unreasonable financial burdens with respect to the purchase of the existing franchise. A franchisor may then find itself in the unenviable position of “passing” on a business deal that a franchisee has made with the risk that, if a franchisor “vetoes” the transaction, a franchisee will, in all likelihood, bring a legal action against it.*

*Some sentiment has been expressed that it would be better for a franchisor to merely pass on a franchisee’s qualifications as a member of the franchise system and to let each transaction rise or fall on its own. Further, many franchisees might feel that they should have the ability to freely dispose of their economic interest in a franchise without a franchisor having the ability to say that the price at which they are selling the interest is “too high.” Perhaps full financial disclosure by a franchisee would help alleviate some of the problems which arise here.*

## **STANDARD 11.7 TRANSFER UPON DEATH, DISABILITY OR INCOMPETENCY**

A franchisee should have a reasonable right to transfer his or her franchised business upon death, disability or incompetence.

**Commentary:** *Proposed by subcommittee (not adopted): A number of issues can be raised in this context. For example, what if there is no “family” or “partner” to whom the franchise business can be transferred upon the death, disability or incompetence of a franchisee? In this event, a franchisor should have the “Right of First Purchase” as discussed in Standard 11.3.*

*One could argue that provisions with respect to “minimum price” formulas, etc. could be utilized with respect to this type of provision. The counter argument is that, if a franchisee has been unable to find a purchaser within a 12-month period (and perhaps a longer period upon of death), then a franchisor should not be required to maintain the franchise in “limbo” without a truly qualified owner in place.*

## STANDARD 11.8 SECURITIES OFFERINGS

A franchise agreement should contain a provision permitting ownership interests or securities in a Franchisee entity to be offered to the public, by private offering (if applicable) or otherwise, with the prior written consent of the Franchisor. A Franchisor may condition its consent on the following requirements:

- a. Management's ability and intent to support the system;
- b. Franchisor is provided with a written opinion of counsel letter paid for by the Franchisee confirming that the Franchisor is not assuming any liability or expense in connection with the offering;
- c. All materials required for such offering by federal, state or other applicable law, be submitted to Franchisor for its review prior to being filed with any governmental agency;
- d. The offering shall not expressly state or imply that the Franchisor is participating in the underwriting, issuance or offering of the Franchisee's securities or that the Franchisor has endorsed the offering; The Franchisor may require a written provision in the offering documents as prescribed by it concerning the limitations described in the preceding sentence;
- e. The Franchisee agrees to fully indemnify Franchisor in connection with the offering;
- f. Franchisee agrees to reimburse Franchisor for its reasonable legal fees in reviewing the proposed offering;
- g. Franchisee shall give Franchisor written notice at least ninety (90) days prior to the date of any offering or other transaction contemplated by this paragraph.

*(Standard passed by a vote of 13 in favor, 3 against, 1 abstention on May 1, 2003)*

**Commentary:** *Proposed by subcommittee (not adopted): The subcommittee has suggested the following proposed commentary: if appropriate, the franchise agreement should state the conditions applicable to a franchisee securities offering.*

*This provision will not be appropriate to many franchise agreements due the type of business franchised, legal constraints, and economic factors. However, if it is feasible for franchisees to make a private or public offering, language allowing for the offer and sale of securities should be included. A franchisor may require certain restrictions, such as a franchisee must remain the majority shareholder. A franchisor should be given the right to review the offering materials for accuracy before they are distributed to the public, and a franchisee should indemnify franchisor for claims concerning the securities offering. A franchisor should also be able to charge franchisee a reasonable offering fee and its actual costs, including reasonable attorney's fees.*

# CHAPTER 12.

## Default and Termination

### **STANDARD 12.0 GENERAL STANDARD**

Events of default should be related to material breaches by a franchisor or a franchisee. The consequence of termination should be reasonable and protect the interests of the non-defaulting party.

*Commentary:* [to be drafted]

### **STANDARD 12.1 DEFAULT BY A FRANCHISOR**

A franchise agreement should contain a provision setting forth material events of default by a franchisor, a franchisee's right to termination for good cause after notice and reasonable time to cure, where appropriate and the parties' post termination rights and obligations.

*(Amended on November 12, 2010 by a vote of 10 in favor and 0 opposed)*

*Commentary:* Many franchise agreements provide detailed instances of franchisee default but make no provision for default by the franchisor, or the consequences of default. If a franchisor defaults in performance under the franchise agreement there should be a fair and effective remedy. If the default is material there may be grounds to terminate the agreement for cause, and the remedy should afford the franchisee the right to protect its business interests. For example, if the franchisee terminates for cause it may be appropriate to be protected from post termination competition from the franchisor. If the franchisor has proprietary technology, the franchise agreement should address some form of reasonable remedy or compensation.

*(Amended on November 12, 2010 by a vote of 10 in favor and 0 opposed)*

### **PROPOSED STANDARD 12.2 WITHDRAWN (NOVEMBER 12, 2010).**

Withdrawn by the committee on November 12, 2010. See commentary to Standard 12.1 regarding the rights and obligations of the parties upon a franchisor's default.

### **STANDARD 12.3 DEFAULT BY A FRANCHISEE**

A franchise agreement should contain a provision setting forth material events of default by a franchisee, a franchisor's right to terminate for good cause, after notice and a reasonable time to cure, where appropriate,

and a franchisee's post termination rights and obligations.

**Commentary:** [to be drafted]

#### **STANDARD 12.4 WITHDRAWN (NOVEMBER 12, 2010)**

Withdrawn by the committee on November 12, 2010. See commentary to Standard 12.1 regarding the rights and obligations of the parties upon a franchisee's default. (10-0)

#### **STANDARD 12.5 FRANCHISEE'S RIGHT TO TERMINATE WITHOUT CAUSE**

Parties to a franchise agreement are obliged to honor the terms of the agreement during its term. However, franchisors are encouraged to implement guidelines pursuant to which, under circumstances of extreme hardship, economic or otherwise, a franchisee may be permitted to terminate its franchise.

*(Standard Passed 13:2, October 2, 2003)*

**Proposed Commentary (not adopted):** *This standard is not intended in any way to diminish the importance of honoring contractual obligations by any party. Nevertheless, this standard recognizes and respects a franchise system that adopts a non-contractual written policy of compassion by providing lenient terms for ending the franchise relationship under circumstances of extreme hardship or extreme underperformance of obligations without intentional cause. Such policies should be enforced in the sole discretion of the franchisor. (On October 2, 2003, commentary was referred back to sub-committee for further reconsideration with a notation that the committee's general feeling is that the commentary, as drafted, does not add any depth or breadth to the standard which was passed on this day.)*

#### **STANDARD 12.6 CROSS DEFAULTS AMONG FRANCHISE AGREEMENTS.**

Generally, a default under a franchise agreement with respect to a particular franchised business or unit should not, in and of itself, constitute a default with respect to other franchised units owned by the same franchisee.

*(Adopted November 12, 2010 by a vote of 8-0)*

**Commentary:** While the consensus of the committee is that generally a default of a franchise agreement should not result in termination of other agreements of the same franchisee, some members of the committee believe that certain defaults may appropriately constitute grounds for termination of such other agreements if the default is material and the conduct constituting the default would cause a material adverse impact to the franchise system.

*(Adopted November 12, 2010 by a vote of 8 in favor 0 opposed)*

# CHAPTER 13.

## Restrictions on Competition

### STANDARD 13.0 GENERAL STANDARD

Restrictions on competition apply to a franchisee only if a franchisee defaults under the franchise agreement, should be reasonable in scope, duration and geography and should protect the legitimate business interests of the franchisor.

*Commentary: Proposed by subcommittee (not adopted): Covenants not to compete are restraints on trade which are disfavored in the law. Enforcement of a covenant not to compete in the franchise context can often require that a franchisee forfeit his entire capital interest in a long term business relationship. Such a forfeiture is inherently harsh and unfair. Some states absolutely prohibit the use of post term non-competition covenants. Others allow the use of post term non-competition covenants provided they are reasonable in scope, duration and geography and protect the legitimate business interests of the party seeking to enforce the covenant. The last requirement dealing with the protection of a legitimate business interest is very significant, for many businesses requiring a post term non-competition covenant do not have a legitimate business interest in enforcing the restrictive covenant. The general standard recognizes and incorporates the prevailing legal standards, but limits its application to the situation where the franchisee has defaulted. Otherwise the franchisee might be required to forfeit his or her entire business interest in the franchise upon expiration of the franchise agreement. Standard 13.1 which follows, provides that the franchisee should not be subject to any non-competition covenants, provided the franchisee is not in default and no reasonable right of renewal has been offered by the franchisor. An alternative may be to provide the franchise with the opportunity to buy out of the franchise pursuant to an agreed formula which recognizes the respective interests of the parties.*

### STANDARD 13.1 FRANCHISEE'S COVENANT NOT TO COMPETE - POST-EXPIRATION

Upon the expiration of a franchise agreement, where the franchisee is not in default and where no reasonable right of renewal is afforded a franchisee, the franchisee should not be subject to any covenant not to compete unless supported by separate, new and adequate consideration.

*Commentary: Proposed by subcommittee (not adopted): Historically, most franchise agreements have non-compete agreements applicable to a franchisee after the end of the term of the franchise. A franchisee following the expiration of the franchise agreement should be prohibited from using the trademarks and trade dress of a franchisor but a franchisee should not be prohibited from continuing in the same type of business. If a franchisor insists upon this type of non-compete, then the non-compete agreement should be supported by new, separate additional consideration. Covenants not to compete which restrict a franchisee's post-termination use of a franchisor's legitimate confidential information and trade secrets should be enforceable.*

## **STANDARD 13.2 POST-TERMINATION PROTECTION UPON DEFAULT BY FRANCHISOR**

In those instances where the franchisor is in material default of its obligations owed to the franchisee resulting in the termination of the franchise, the agreement should provide reasonable protection for the terminating franchisee with due regard for the interests of the other franchisees in the system. Such protection might include relief from a post-termination restrictive covenant.

*(Standard adopted November 19, 2001 by a vote of 8-1)*

**Commentary:** *(Proposed by subcommittee -not adopted): This standard recognizes that when the franchisor breaches the franchise agreement or defaults on its obligations owed to its franchisees, it should be subject to a reciprocal post-term non-competition covenant. A breaching or defaulting franchisor should not be permitted to set up a competing franchise outlet in close proximity to its former franchisee. It should be subject to the same post term non-competition covenant that it sought to impose on its former franchisee.*

## **STANDARD 13.3 COVENANTS NOT TO COMPETE - IN-TERM**

Non-competition covenants between a franchisor and a franchisee during the term of the franchise agreement should be permissible provided that they are mutual, reasonable and necessary to protect the integrity of the system.

**Commentary:** *(Proposed by subcommittee -not adopted): There should be mutuality of obligation of a franchisor and a franchisee's respective in-term covenants not to compete. A franchisee should not be required to sign an in-term non-compete agreement unless a franchisor is willing to do likewise. Both parties should be willing to respect the other's business during the term of the franchise agreement.*

## **STANDARD 13.4 COVENANTS NOT TO COMPETE FOLLOWING TERMINATION OF A FRANCHISE AGREEMENT FOR CAUSE**

If there is a default by a franchisor or franchisee resulting in the termination of the franchise agreement, a covenant not to compete that is reasonable in time, geographic area and scope is appropriate provided the covenant protects a legitimate business interest of the non-defaulting party.

**Commentary:** *(Proposed by subcommittee -not adopted): Again, it is a question of mutuality of obligation. If there is a default by a franchisee or a franchisor and the contract is terminated by the non-defaulting party after notice and reasonable opportunity to cure, the non-compete agreement should apply to the defaulting party but not the non-defaulting party.*

## **STANDARD 13.5 FRANCHISOR'S ACQUISITION OF A COMPETITIVE BUSINESS**

Upon a franchisor's acquisition of a competitor's system or units which violates a non-competition covenant, a franchisor should be required to remedy the violation within a reasonable period of time.

**Commentary:** *Proposed by subcommittee (not adopted): A franchisor should not be competing with its franchisees whether it be with the same trademark or trade dress or with another trademark and trade dress controlled by the same franchisor in the same type of business.*

## **STANDARD 13.6 FRANCHISORS DUTY TO ENFORCE COVENANT NOT TO COMPETE**

If a reasonable covenant not to compete is violated by a franchisee, a franchisor should take reasonable steps to enforce the covenant to protect the integrity of the franchise system and its other franchisees.

**Commentary:** *Proposed by subcommittee (not adopted): This standard incorporates the franchisor's duty to protect the franchise system in cases where a defaulting franchisee may be violating a covenant not to compete. The standard*

*is based upon reasonable conduct, for it may often be in appropriate or otherwise unwise for a franchisor to attempt enforcement of a covenant not to compete. Allowing a disgruntled franchisee to leave the system may be a more effective method of protecting its integrity. The use of the reasonable conduct standard affords the franchisor the opportunity to deal with each situation under the facts and circumstances that arise at that time.*

# CHAPTER 14.

## Dispute Resolution

### STANDARD 14.0 GENERAL STANDARD

The parties to a franchise agreement should make good faith efforts to resolve disputes on the merits arising out of or related to the franchise agreement quickly, fairly and inexpensively. Neither party should be required to waive the protections afforded him, her or it under applicable state and federal law. Alternative dispute resolution procedures which offer adequate protection for a substituted fundamental right, may be utilized, if and only if, consent for the substitution is freely given and actually negotiated.

**Commentary:** *Proposed by subcommittee (not adopted): Three objectives for the model Standards for dispute resolution exist:*

- 1. Model Standards that offer a speedy, inexpensive and just resolution of all disputes on the merits is required. This concept is not only consistent with Rule 1 of the Federal Rules of Civil Procedure, but is also a necessary and desired goal of any model dispute resolution standard. All too often the superior economic position of one party permits abuse of the civil litigation process, whether that process is public (pled in Court) or private (arbitration or mediation conducted outside the auspices of Court imposed alternative dispute resolution programs);*
- 2. The model Standards cannot require either party to give up fundamental rights, in particular, constitutional rights such as the right to a jury trial in a civil case. The Committee supports substitution of alternative dispute resolution procedures which offer an adequate quid pro quo for this substituted fundamental right, if and only if, consent for the substitution is freely given and the substitution is actually negotiated;*
- 3. Common law and statutory protections and remedies available to all parties in a dispute have to be preserved wherever possible. Much of the currently existing statutory and common law legal framework applicable to franchising developed in response to abuses in the franchise industry. To help foster balance in the franchise relationship and create true mutuality of obligation, the Committee supports the retention of all existing legal rights and remedies for all parties. The model Standards must also be consistent with existing federal and state law because issuance of model Standards that conflict with those legal mandates would make the model Standards meaningless.*

### STANDARD 14.1 MEDIATION

Except in cases where equitable or injunctive relief is sought, the parties to a franchise agreement should first participate in good faith non-binding and confidential mediation before the institution of any formal legal proceedings. Mediation should be under the auspices of an alternate dispute resolution forum as agreed to by the parties (and recognized by the state judicial system, if applicable); no party shall be required to attend any

mediation session brought by a franchisor including mediators who are the employees, agents or representatives of the franchisor. The institution of mediation proceedings should toll any applicable statute of limitation related to the mediated claims pending the outcome of the mediation.

**Commentary:** *Proposed by subcommittee (not adopted): Non-binding mediation prior to any formal legal proceedings offers the best chance for a speedy, inexpensive and just resolution of disputes on the merits. This model Standard is not intended to abrogate any fundamental rights nor impact existing state and federal common law or statutory rights. While there is some possibility for abuse, the non-binding nature of the model standard coupled with the good faith requirement to participate in such proceedings at the beginning of the dispute resolution process should tend to minimize that risk. The exceptions of equitable or injunctive relief were considered too fundamental to the rights of the parties to be abrogated by this model standard. In addition, mediators are not empowered to even award, nor enforce any orders granting injunctive relief.*

## **STANDARD 14.2 ARBITRATION**

Binding arbitration should be encouraged as an alternative form of dispute resolution on the merits, provided it is speedy, fair, and inexpensive and designed to produce a just result. An arbitration clause to which consent is freely given is an adequate substitution for the fundamental right to jury trial, if and only if, the arbitration clause contains the following protections:

- a. All claimants with substantially similar claims may join the proceedings; All parties who may be legally responsible agree to participate in the arbitration and all potential legal claims can be joined in the arbitration forum;
- b. The rules governing the conduct of the arbitration proceedings are consistent with generally prevailing standards of due process;
- c. The panel from which the arbitrator(s) are chosen is comprised of persons knowledgeable in the franchise industry and who have demonstrated a capability for unbiased decision-making consistent with the principles embodied in the Commercial Rules of the American Arbitration Association for appointment of neutral arbitrators;
- d. Limited discovery is allowed, consistent with Rule 10 of the Commercial Rules of the American Arbitration Association and pursuant to a discovery plan approved by the arbitrator(s);
- e. Actual hearing on the merits occurs within six months of the date of the filing of the arbitration proceeding;
- a. A reasoned written opinion on the merits is issued by the arbitrator(s) within 30 days of the completion of the hearing(s) on the merits.

**Commentary:** *Proposed by subcommittee (not adopted): In recent years, the concept of private justice has gathered momentum as court dockets have become backlogged with increased filings and procedural delays caused at least in part by the deliberate decision of some litigants to delay and increase litigation costs as a method of defeating legitimate claims. The concept of private justice that must be purchased is repugnant to many of the fundamental precepts underlying the Constitution of the United States and the constitutions of many of the individual states. Binding arbitration has been increasingly abused by litigants and has become a profit center for those who provide the service. The contractual nature of arbitration ordinarily prohibits joinder of all parties and claims thereby allowing procedural abuse by the whipsawing of litigants and claims back and forth between parallel court and arbitration proceedings. Some parties routinely demand multiple arbitrators at large hourly rates, which can easily cost the parties to the dispute thousands of dollars for even the most trivial of procedural decisions. The discovery process has also been abused, especially in complex cases, where arbitration has become the equivalent of a full-blown court case, without any of the constitutional, procedural or substantive legal protections available in a court of law. Potentially biased arbitrators who are either incapable of being fair to both parties, or who are not competent to decide a franchise case, compound the dilemma.*

*Informed consent is required to the inclusion in a franchise agreement of an arbitration clause before signing the fran-*

chise agreement. This requirement insures that for those franchise agreements that contain an arbitration clause, the franchisee clearly makes an informed decision to give up fundamental rights such as the right to a civil jury trial, before signing the franchise agreement. The standard is not intended to require the actual negotiation of the procedural mechanics of the arbitration clause in each individual agreement. Many franchisors would have difficulty managing scores of arbitration clauses with different procedural rules. By the same token, however, the parties are always free to negotiate different procedural mechanics for the operation of an arbitration clause in any individual agreement. An arbitration clause, to which a franchisee does agree, should contain certain procedural safeguards.

*This Standard is intended to restore the concept of speedy, fair, inexpensive and just adjudication of disputes on the merits as an adequate quid pro quo for the waiver of the fundamental right to a civil jury trial.*

### **STANDARD 14.3 WAIVER OF JURY TRIAL**

The right to a trial by jury is a fundamental right afforded to all persons. Neither party should be compelled to waive its constitutional right to trial by jury on all issues so triable.

**Commentary:** *Proposed by subcommittee (not adopted): The Seventh Article of Amendment to the Constitution of the United States guarantees the right of each citizen to a trial by jury in all civil cases involving a controversy with more than \$20 in dispute. This fundamental right to jury trial also appears in the constitutions of many of the individual states. The model Standard substitutes person for citizen. No person can be compelled by contract to give up fundamental rights unless consent is freely given and an adequate quid pro quo is substituted for the right to jury trial as set forth in other Standards.*

### **STANDARD 14.4 CHOICE OF LAW**

The franchise agreement should not require the franchisee to agree to be governed in any litigation relating to the franchise agreement or any other agreement between the parties by the laws of any state other than the state in which the franchisee's business is located unless consent for the substitution is freely given and actually negotiated. No franchise agreement should limit any additional legal protections afforded to the franchisee's business under applicable state law.

**Commentary:** *Proposed by subcommittee (not adopted): Choice of law clauses have been the subject of much procedural litigation. In decades past, courts were often content to look at the written agreement of the parties and enforce any agreements imposing the law of a particular state upon the rights and relations of the parties. In cases where there was no written agreement, many courts utilized a lex loci or place of the injury test to determine which state's law should apply to the dispute.*

*Modern jurisprudence has increasingly focused upon the jurisdiction, which has the most significant relationship to dispute, transaction, parties or claim(s). Because laws vary from state to state, the applicable choice of law can be a critical issue. The "choice of law" may depend on the nature of the claim, such as contractual, tortuous, equitable, statutory, as well as a particular state's "fundamental public policy." Preference for one state's law over another may also depend upon whether the law is procedural or substantive.*

*Many states passed laws limiting a franchisor's rights to terminate and requiring certain disclosures prior to offering a franchise for sale. Contractual choices of law clauses were frequently used to cut off those rights. The difference between such terms as "construed under" or "governed by" became of paramount significance in determining the ultimate set of rules or laws to be applied to a legal dispute.*

*Since most jurisdictions do not enforce contractual choice of law provisions without analyzing the significance of the relationship with the state's law selected and the fundamental public policies of all states involved, the model Standard must comport with contemporary legal jurisprudence on conflict of laws. In addition, the model Standard prohibits "drafting around" franchise or other state laws providing such legal protection.*

## STANDARD 14.5 VENUE

As to any mediation, arbitration, litigation or other dispute involving one or more franchisees in the same jurisdiction and the franchisor, the dispute should be resolved in the county or district in which the franchisees' business is located. In any dispute involving the franchisor and two or more franchisees from different jurisdictions, the dispute should be resolved in the county or district where the franchisor's principal office is located.

**Commentary:** *Proposed by subcommittee (not adopted): Historically, most franchise agreements have provided that venue is where the principal office of the franchisor is located. This is often hundreds or thousands of miles from the franchisee. This provision has had a chilling effect on the ability of franchisees to assert valid claims because of the time, cost and distance involved including the availability of witness. Additionally, franchisors voluntarily decide to conduct business or offer franchises in the franchisees' jurisdiction, and usually have greater resources to conduct litigation. Several states (California, Connecticut, Illinois and Michigan) require as a condition to a franchisor being registered in the state that venue be where the franchised business is located. The theory behind the registration requirement is that if a franchisor wants to franchise in a state, it should also be willing to resolve its disputes within that jurisdiction.*

## STANDARD 14.6 ATTORNEY'S FEES

Each party should bear its own attorney's fees, costs and expenses incurred in any mediation process. Except as otherwise provided by statute or public policy, in any arbitration, legal action or other proceeding (other than mediation) to enforce a franchise agreement or concerning any alleged dispute, breach, default or misrepresentation involving the terms of a franchise agreement or the franchise relationship, the parties should agree that the prevailing party is entitled to request that all reasonable attorney's fees, court costs and expenses be paid by the non-prevailing party. The ultimate determination as to whether, and the amount of, those fees, costs and expenses shall be so paid should rest in the discretion of the court or arbitrator.

**Commentary:** *The attorney's fees standard was intended to offer the potential for an award of attorneys' fees to the prevailing party. Some members of the committee believe it would be preferable to apply the American Rule regarding attorney's fees that provides that each party pays its own legal fees. These members suggest that adoption of the English system of loser pays would tip the balance in a dispute to the party which can most afford to pay legal fees. The less affluent party, (in most cases the franchisee), would be virtually precluded from litigating because of the substantial risk which exists that it would have to pay the attorneys' fees of the opposing party if it lost.*

## STANDARD 14.7 LIMITATION OF CLAIMS OR ACTIONS

Limitations of claims or actions are governed by the laws of the individual states. Therefore, no party should be required to agree to a limitation of claim or action less than that set forth by the legislature or governing law in the state where the franchisee's business is located.

**Commentary:** *There is no mutuality in the contract clauses that currently are used to limit claims. Such clauses are antithetical to the goals of the Committee relating to dispute resolution. Neither party should be required to give up existing fundamental or legal rights, as a pre-requisite for signing a franchise agreement; therefore, the standard does not support limitations of claims or actions.*

## STANDARD 14.8 PUNITIVE DAMAGES

Franchise agreements should not contain a provision whereby either party waives the right to seek punitive damages, if the facts warrant that relief and applicable procedural or substantive law allows the award of punitive damages.

**Commentary:** *Punitive damages are a powerful remedy available to both franchisor and franchisee in those states which permit the award of punitive damages. Even in states that do prohibit punitive damages, arbitration clauses*

often empower the arbitrator to make such awards. The model Standard is consistent with the goals of the Committee as they relate to dispute resolution.

## **STANDARD 14.9 LIMITATION ON DAMAGES**

Subject to Standard 14.10 regarding Liquidated Damages, Franchise agreements should not contain limitations or caps on damages recoverable by either party to a dispute.

*(Approved Unanimously April 28, 2000)*

**Commentary:** Some franchise agreements attempt to limit or eliminate damages recoverable in a dispute. This contractual device is the inverse of a liquidated damages clause that purports to set the precise amount of damages recoverable for a particular breach. A limitation or cap on damages, which is most often unilateral in favor of the franchisor, is even more objectionable. Such caps or limitations eliminate the mutuality of obligation that should be the hallmark of a model franchise agreement and insulate a breaching or defaulting franchisor from its failure or refusal to perform its legal obligations.

*(Commentary approved unanimously April 28, 2000)*

## **STANDARD 14.10. LIQUIDATED DAMAGES**

Liquidated damage clauses are appropriate in a franchise agreement, provided that they are not punitive in nature, and that they reflect the parties good faith efforts to establish their reasonable expectations to be derived from the franchise agreement, and where they balance the legitimate business interests of the franchisor and the franchisee.

*(Approved April 28, 2000 by a vote of 6 to 1)*

**Proposed commentary (not adopted):** Subcommittee of Cynthia Gartman, Bob Purvin & Michael Hanks. Suggest the following. "Most liquidated damages clauses are unenforceable as penalties unless they are reasonable and approximate the damages suffered."

## **STANDARD 14.11 GROUP AND CLASS ACTIONS**

Collective action is a fundamentally important method of resolving some disputes. Franchisees should be permitted to bring group or class actions of common issues, and franchisees should not be required to waive existing procedural or statutory rights to bring group or class actions of common issues.

*(Approved unanimously on April 28, 2000)*

**Commentary:** Collective action is a primary vehicle for less advantageous parties to a relationship to effectively prosecute their grievances. Standard 14.2 recognizes that arbitration clauses should not be permitted in franchise agreements unless collective action is contemplated by the arbitration clause and all parties to the dispute are required to participate in binding arbitration. Unless the standard for arbitration as set forth in Standard 14.2 is fully met, no franchisee should be required to waive existing procedural or statutory rights to bring class actions of common issues. Such waivers eliminate the mutuality of obligation required in a franchise agreement by these standards.

*(Commentary approved unanimously on April 28, 2000)*

# CHAPTER 15.

## Disclosure Requirements

### STANDARD 15.0 GENERAL STANDARD

Before a franchise is sold, a franchisor should comply fully with its legal disclosure obligations, including disclosure of all material information that would affect a franchise investment decision. Furthermore, a franchisor should make a good faith effort to disclose the positive and negative aspects of the franchised business and franchise relationship.

**Commentary:** The FTC Franchise Rule and state franchise disclosure laws represent the minimum level of disclosure to a prospective franchisee. A franchisor should disclose all material information necessary for a person to make an informed investment decision.

### STANDARD 15.1 EARNINGS CLAIMS

A franchisor should disclose at a minimum the gross sales performance or its equivalent of company owned units and franchise units in accordance with Item 19 of the Uniform Franchise Offering Circular Guidelines or the FTC Franchise Rule.

**Commentary:** At a minimum, a franchisor should disclose gross sales information available to it. Additional information, such as operating costs and net income before taxes, would be even more meaningful. The data should be compiled and disclosed by relevant market area. At a basic minimum, franchisors should not be able to refuse to respond to a reasonable request for data (accessible to the franchisor) on a confidential basis from qualified prospective purchasers (prospects who have already been invited to apply for a franchise). The data disclosed, if prepared in accordance within narrow guidelines, should not be used against a franchisor, as long as it is accurate, can be substantiated and is not misleading. Earnings claims disclosure does not replace a franchisee's duty to investigate. (See Standard 15.2)

### STANDARD 15.2 DUE DILIGENCE BY PROSPECTIVE FRANCHISEES

A franchisee has an obligation and duty to exercise reasonable diligence in investigating and evaluating the proposed franchise opportunity to determine whether the offered franchised business is a suitable investment for the qualifications, aptitude, temperament and financial capabilities for the prospective franchisee. The franchisor should require evidence of the franchisee's exercise of diligent investigation and evaluation in the form of a certification by the franchisee as to the particulars of the investigation and a certification of the franchisee's legal and financial counsel that they, respectively, have, at a minimum, reviewed the franchise agree-

ment, Uniform Franchise Offering Circular (or its equivalent), the franchisee's business plan (if any exists), and have had the opportunity to discuss the franchisee's rights, obligations, opportunities and risks associated with the proposed investment.

**Commentary:** *A prospective franchisee should attempt to educate himself about the business, the industry and the nature of the franchisor/franchisee relationship before purchasing a franchise. A prospective franchisee is well advised to retain an accountant to assist in the preparation of a business plan with 3 to 5 year financial projections. A prospective franchisee is also well advised to retain an experienced franchise attorney to advise him or her on the terms of the franchise agreement and, where appropriate, to seek to negotiate the provisions of the franchise agreement with the franchisor. Whether or not the franchisor utilizes a collectively negotiated franchise agreement is an area of reasonable inquiry for the franchisee.*

### **STANDARD 15.3 FRANCHISEE GAG ORDERS**

Full disclosure of a franchisee's experience, including franchisor/franchisee disputes, is encouraged. Nevertheless, while not favored, in order to encourage the settlement of disputes, the use of covenants not to disclose the specific terms of settlement may be appropriate, except where restricted by law. In its Uniform Franchise Offering Circular, the franchisor should inform prospective franchisees of the existence of so-called "gag clauses," or "covenants not to disclose", if any were included in any type of agreement(s) within the last three (3) fiscal years.

*(Standard approved unanimously on June 6, 2002)*

**Proposed Commentary (Not adopted):** *If such agreements exist, the franchisor should have an affirmative duty to bring to the attention of a prospective franchisee the fact that certain former and/or current franchisees may be unable to share certain information with the prospective franchisee. Just as the proponents of the expanded Franchise Rule suggest, a franchisor may inform a prospective franchisee of the number and/or the percentage of its current and former franchisees whose ability to share information would be restricted in this fashion. This allows the franchisor who has seldom utilized "gag clauses" to inform a prospective franchisee of that fact.*

### **STANDARD 15.4 FRANCHISOR SELLING EXISTING COMPANY-OWNED BUSINESS UNIT with FRANCHISE LICENSE**

In addition to the other requirements of this Chapter, when a franchisor is selling an existing company-owned business unit with the franchise license, the franchisor should disclose the following information to a qualified prospective franchisee: (i) financial information relating to the particular business unit's historical performance, including gross sales and operating costs; (ii) information known to the franchisor which would reasonably be anticipated to have a material impact on the future financial performance of the particular business unit; (iii) explanations of material cost changes that might result from the transaction such that the historical information regarding the company-owned unit's performance will not be misleading; (iv) information regarding whether the particular business unit was originally developed by a franchisee then later acquired by the franchisor, and the reasons for the transfer and acquisition.

*(Standard approved 16-0 with 1 abstention on October 5, 2004)*

**Proposed Commentary:** *Consistent with the principle that a franchisor should disclose all material information that would affect a franchise investment decision (Standard 15.0) including information relating to sales or financial performance (Standard 15.1), this Standard addresses the situation where the franchisor has access to detailed, material information regarding the particular business unit at issue. Under such circumstances, full disclosure of all material information known to the selling franchisor should be made available to a qualified franchise prospect (prospects who have already been invited to apply for a franchise). The fact that the recipient of the information has already been "qualified" by the franchisor, and the fact that the information regarding this*

*particular business unit may be provided on a confidential basis adequately protect the franchisor's interest in maintaining the confidentiality of its business information.*

## **STANDARD 15.5. REPRESENTATION DISCLAIMERS.**

Without limiting any obligations that a franchisor might have under applicable law, a franchisor should not disclaim or require a franchisee to waive reliance on any representation made in the franchisor's disclosure document, including its exhibits or amendments, or in the franchisor's authorized written or visual franchise marketing materials.

*(Adopted May 6, 2008 by a vote of 12 in favor, 2 opposed)*

**Proposed commentary:** *This prohibition is intended to prevent fraud by preserving the completeness and accuracy of information contained in disclosure documents. Franchisors routinely seek to disclaim liability for statements made in their disclosure documents through the use of blanket contract integration clauses in their franchise agreements. By signing a franchise agreement containing such a clause, franchisees arguably waive any rights they may have to rely on information contained in the disclosure document. The use of such clauses, therefore, may lead to deception by enabling franchisors to make incomplete, inaccurate, or even false statements in their disclosure documents, while prospects effectively waive reliance on any such statements by signing the franchise agreement.*

*The integrity of a franchisor's disclosure document is critical to prospective franchisees. The prevalent use of integration clauses to disclaim liability for required disclosures undermines the very purpose of the disclosure document, which is to prevent fraud and misrepresentation in the pre-sale process by ensuring prospective franchisees have complete and truthful information from which to make sound investment decisions.*

# CHAPTER 16.

## General Releases

### STANDARD 16.0 GENERAL STANDARD

General releases are permissible in connection with the resolution of bona fide disputes between a franchisor and a franchisee, and, in most situations, should be mutual.

**Commentary:** When a party (releasing party) signs a general release, he or she is releasing any claims which he or she has or may have against the party receiving the release (released party). When the parties are in litigation or otherwise in dispute, as a normal part of the resolution of the litigation or dispute, each party releases the other. This allows the parties to put the dispute behind them as the franchisor/franchisee relationship moves forward. A franchisor should not require a franchisee to sign a release without the franchisor signing a similar release, unless supported by adequate consideration.

### STANDARD 16.1 RELEASE OF PRIOR CLAIMS

A franchisor should not include a provision in a franchise agreement whereby a franchisee releases any prior claims against the franchisor.

**Commentary:** Some franchise agreements contain a “release of prior claims” provision whereby, on the franchisee’s signing the franchise agreement, a franchisee releases a franchisor from any prior claims a franchisee may have against a franchisor including a franchisor’s violation of the franchise laws. In some states this provision is unenforceable. The committee believes these clauses should not be included in a franchise agreement.

### STANDARD 16.2 GENERAL RELEASE ON SALE OR TRANSFER

A franchisor should not require a general release from a franchisee as a condition of the franchisor’s consent to a sale or transfer of a franchised business by the franchisee.

**Commentary:** *(Proposed by Committee - not adopted)* Many franchise agreements contain a provision that the franchisee must give the franchisor a general release as part of the franchisee’s sale or transfer of the franchised business. If the franchisee has a valid claim against the franchisor at the time of sale or transfer, the franchisee must either dismiss the lawsuit if he or she wants the sale or transfer to go through or forego the sale or transfer until the litigation is over.

### **STANDARD 16.3 GENERAL RELEASE ON RENEWAL**

A franchisor should not require a general release from a franchisee as a condition to the franchisor's grant of a successor or renewal franchise agreement.

**Commentary:** *Many franchise agreements also contain a provision that the franchisee must give the franchisor a general release as a condition to the franchisor offering the franchisee the option to renew the franchise agreement. If the franchisee has a valid claim against the franchisor at the time of renewal, the franchisee must either dismiss the lawsuit (if he or she wants to renew the franchise), or cease being a franchisee and possibly be subject to a post-expiration covenant not to compete.*

# CHAPTER 17.

## Real Estate Issues

### **STANDARD 17.0 GENERAL STANDARD**

Where the site of a unit is important to the success of the franchisee's business, a franchisor should provide reasonable assistance to the franchisee regarding the location and the business premises.

**Commentary:** [to be drafted]

### **STANDARD 17.1 SITE SELECTION AND LEASING ASSISTANCE**

The franchisor should disclose to the franchisee the nature and extent of leasing and/or site selection assistance prior to the franchisee entering into the franchise agreement. . Where the franchisor provides such leasing or site selection assistance, it shall do so in good faith and in a reasonably prudent manner.

*(Adopted unanimously April 28, 2000)*

**Commentary:** Since the manner and extent to which franchisors provide leasing assistance to franchisees varies from system to system, it is important for a prospective franchisee to know whether the franchisor will be choosing the franchisee's location, assisting the franchisee in choosing such location, negotiating the lease with respect to such location, or assisting the franchisee in negotiating the lease. It was the view of the subcommittee, in any case, that reasonable assistance should be provided by the franchisor to the franchisee in connection with the selection, and where applicable, the leasing of the franchised location. The franchisor should utilize such economic criteria, demographic data and models as it has available to it in providing such assistance to its franchisees.

*(Adopted unanimously April 28, 2000)*

### **STANDARD 17.2 LEASING OR SUBLEASING FROM FRANCHISOR OR AFFILIATE**

The basic business terms of a lease or sublease should be subject to negotiation between a franchisor and a franchisee and should balance the legitimate business interests of a franchisor as a landlord and the legitimate business interests of a franchisee as a tenant.

*(Adopted unanimously on April 28, 2000)*

**Suggested Commentary proposed by subcommittee (not adopted):** *Where the franchisee has either leased or sublet its business premises from the franchisor, a cross-default provision should be contained in any lease or sublease between the parties or their affiliates. However, the termination of such a lease or sublease by the franchisor should not prejudice the rights of a franchisee where a legitimate dispute exists between the franchisee and the franchisor under their franchise agreement.*

*On renewal of the lease or sublease, there should be a formula to provide for a "fair market value rent" with respect to the premises. The fair market value rent should take into account the methods and financial arrangements utilized by a franchisor in leasing similar space to its franchisees within the franchise system, if applicable. If a franchisor and a franchisee are not able to agree upon the fair market value rent within a certain defined time period, an arbitration provision should be utilized so that the fair market value rent can be determined.*

### **STANDARD 17.3 RELOCATION RIGHTS**

A franchisee should have the opportunity to relocate its franchised business if the lease or sublease for the franchised premises expires or is terminated during the term or any renewal term of the franchise agreement.

*(Adopted unanimously April 28, 2000)*

**Commentary:** If a franchisee has leased its premises other than from a franchisor, a provision should be contained in the franchise agreement which would give a franchisee the opportunity, over a 6 to 12 month period (with some portion preceding the expiration date of the lease and some portion extending beyond the expiration date) to locate alternative premises for the franchised business. The criteria for locating the premises and for obtaining the franchisor's approval should be similar to those criteria provided in the site selection provisions of the franchise agreement. Similar provisions should apply in the event that the franchisee's lease or sublease is terminated as a result of condemnation, casualty or other forces outside of the control of the franchisee.

If a franchisee has a right to an exclusive marketing area, it should be able to open a replacement location within that marketing area subject to the franchisor's reasonable right of approval. In granting or withholding such approval, the franchisor should utilize the same criteria as it would apply with respect to approval of franchised locations generally.

*(Unanimously approved April 28, 2000)*

### **STANDARD 17.4 CONSISTENCY OF TERM AND RENEWAL PROVISIONS WITH RESPECT TO LEASING OR SUBLEASING FROM A FRANCHISOR**

If a franchisee either leases or subleases its business premises from a franchisor, then the initial term of the lease or sublease should be made consistent with the initial term of the franchise agreement and renewals thereof should be made consistent with the renewal terms of the franchise agreement.

**Commentary:** Incongruent terms of a lease or sublease and a franchise agreement might leave the franchisee in default of the franchise agreement because it has no location, or obligated under an un-expired lease without any right to operate the business at the leased location.

*(Unanimously approved commentary and standard on April 28, 2000)*

# CHAPTER 18.

## Electronic Commercial Issues

### STANDARD 18.0 GENERAL STANDARD

Internet standards should be based on a cooperative effort between the franchisor and its franchisees.

*(Adopted on May 4, 2001 by a vote of 10 to 1)*

**Commentary:** *[Proposed by subcommittee (not adopted)] A strong Internet presence is extremely important to any franchise system. The Internet provides an essential media to market the system, disseminate information about products and services, direct customers to franchise owners, and to directly sell products and services to be serviced by the network. E-commerce can be an essential tool to service the consumer and the franchise network, to disseminate data, and to support the system. The use of the Internet and eCommerce should be employed to augment the franchise system, and not as a tool of encroachment or negative impact on the franchise owner.*

### STANDARD 18.1 OWNERSHIP OF INTERNET TECHNOLOGY

A franchisor should own or control the licensing of all Internet sites associated with the franchise system to the extent that such sites relate to the franchise system's business and operations. A franchisee may be entitled to consideration for innovations contributed to the system's Internet presence and adopted by a franchisor subject to the provisions of Chapter 4.

*(Adopted on November 19, 2001 by a vote of 8:1:0)*

**Commentary:** *Proposed by subcommittee (not adopted): The franchisor, as the creator of a franchise system, generally is the owner of all or most technology associated with the system. Franchisees generally invest in a business in the system on the assumption that the franchisor will be reasonably diligent in maintaining and protecting existing technology and marketing systems to keep the system fresh and competitive, and that the franchisor will not require franchisees to make unreasonably frequent or expensive technology changes.*

*Sometimes franchisees will come up with ideas for new technologies, and will even invest time and money in taking new technologies beyond the idea stage. Generally, those new technologies should be regarded as the franchisors property, subject to the franchisee receiving some reasonable consideration from the franchisor based on the franchisee's return of his or her investment, so that the franchisor can make the new technologies available to all franchisees at no or little cost to them (excluding necessary costs for items such as new signs, displays or advertisements). Presumably, this is one of the benefits of being in a franchise system -- to share in the creativity of the franchisor and other franchisees. In some cases, however, new technologies should be regarded as the*

*franchisee's property, such as when they involve a high degree of creativity or are peripheral to the franchise system, or when the franchisee makes substantial investments in their development. A franchisee's independent development of a line of private brand name products related to the franchise system would be an example of this type of situation.*

## **STANDARD 18.2 THE FRANCHISEE'S RIGHT TO AN INTERNET PRESENCE**

A franchisor and a franchisee each have a shared interest in establishing an internet presence for the benefit of the franchise system as a whole, as well as the franchisee's market, and should work cooperatively to exploit the use of the internet for their mutual advantage. A franchisee should have the right to establish an internet presence to conduct and market its business, subject to a franchisor's right to set reasonable standards and specifications for internet sites.

*(Standard passed by a vote of 18-2 on May 1, 2003)*

**Commentary:** [to be drafted]

## **STANDARD 18.3 FRANCHISORS DUTY TO PROTECT FRANCHISEE'S MARKET**

A franchisor should exercise its rights and duties under this Chapter in a manner that does not negatively impact or encroach upon any franchise owners' reasonable market protection consistent with Chapter 3 of these Standards. A franchisor that sells products and services through e-commerce or other new technologies should be required to keep records of such sales. Reasonable compensation should be provided to franchisees negatively impacted by such sales, unless the franchise agreement specifically exempts such sales. In determining reasonable compensation, the parties should take into account allocation of expenses, royalties and other payments that might be due.

*(Standard passed unanimously November 21, 2002)*

**Commentary:** [to be drafted]

## **STANDARD 18.4 DUTIES REGARDING INTERNET TECHNOLOGY AND SYSTEMS DEVELOPMENTS**

If the franchisor has incorporated the internet or eCommerce into its franchise system, the franchisor should use good faith efforts to keep abreast of Internet and eCommerce technology, software and systems developments. A franchisor should inform its franchisees of these enhancements and developments and should (if economically practical) implement such changes as would be mutually beneficial to both the franchisor and its franchisees.

*(Unanimously approved on May 4, 2001)*

**Commentary:** [to be drafted]

## **STANDARD 18.5 COSTS OF INTERNET TECHNOLOGY MODIFICATIONS**

A franchisor has the right to require franchisees to use its proprietary Internet technology (if any), subject to the franchisor's good faith efforts to update such proprietary Internet technology and to keep the costs reasonable. Subject to Standard 6.5, franchisees are responsible for the cost of acquiring, maintaining and updating necessary proprietary Internet technology to keep the franchise system competitive.

*(Approved at May 4, 2001 by a vote of 11 to 1)*

## **STANDARD 18.6 ALTERNATE INTERNET SERVICE PROVIDERS**

Subject to the franchisor's right to designate the suppliers of proprietary products and services pursuant

to Article 9 of these Standards, and the franchisors reasonable and good faith right of approval, a franchisee should have the right to select any Internet Service Provider that meets the franchisors reasonable and necessary standards and specifications.

*(Unanimously approved May 4, 2001)*

**Commentary:** *Proposed by subcommittee (not adopted): It was discussed that suppliers should have a continuing obligation to meet a franchisor's reasonable and necessary standards as they may change from time to time. Also, a franchisor should approve a reasonable number of suppliers for competitive reasons.*

*It is acceptable for a franchisor to receive payments from suppliers based on purchases by franchisees but only if there is full and complete disclosure in advance to a franchisee.*

## **STANDARD 18.7 INCLUSION OF FRANCHISEES IN INTERNET STRATEGIES**

The franchisor should include its franchisees in discussions and planning with respect to Internet and eCom-merce strategies, implementation and expenditures.

*(Unanimously approved at 5-4-01 meeting)*

**Commentary:** Proposed by subcommittee (not adopted): A franchisor has the right to promote its system and the marks in order to protect the integrity of the marks. This needs to be balanced against a franchisee's need to have a voice in the type and content of advertising conducted. Particularly when a franchisee is required to advertise in its local market, a franchisee should have input into the advertising strategies and expenditures with a franchisors guidance and approval.

## **STANDARD 18.8 SELLING PRODUCTS AND SERVICES BY NEW TECHNOLOGIES**

Where a franchise system seeks to take advantage of opportunities to sell products or services utilizing e-commerce or other new technologies, a franchisor and its franchisees should work cooperatively to protect their respective business interests, giving due regard to the benefits to the brand, mutual obligations of the parties, including market protections provided by the franchise agreement. (Standard passed 8:2 November 21, 2002)

**Proposed Commentary:** *Franchisors and Franchisees should clearly set out in their agreements a determination of how marketing and delivery of products and services by eCommerce or by new technologies will occur and how the related revenues and costs will be allocated.*

## **STANDARD 18.9 ON-LINE REPORTING WITHDRAWN (APRIL 29, 2004)**

Standard was tabled as redundant to Standards already set forth in Chapter 7.

*(Action taken by the whole committee on April 29, 2004)*

## **STANDARD 18.10 ELECTRONIC PAYMENTS of ROYALTIES & FEES**

A Franchisor has the right to embrace current technology regarding electronic funds transfer and payments for the mutual benefit of the franchise system. The use of electronic fund transfers should recognize and respect a franchisees right and ability to control cash flow decisions, including both the power to direct the use of cash and credit resources and the franchisees right to allow or disallow the transfer of funds.

*(Standard passed 8-1 with 2 abstentions October 17, 2005)*

# CHAPTER 19.

## Miscellaneous Provisions

### STANDARD 19.1 INDEMNIFICATION

A franchisor and a franchisee should have mutual indemnification obligations.

**Commentary:** *Proposed by subcommittee (not adopted): A franchisor should indemnify a franchisee for a franchisee's use of any trademarks, trade names, patents or copyrights and other mandated product or procedure as long as the use is consistent with the franchise agreement. Indemnification should include attorneys' fees, court costs and damages, as well as, the cost of any changeover in signage, business cards, stationery, etc.*

A franchisee should indemnify a franchisor concerning his or her operation of the franchised business, and should include environmental indemnity (if permitted by state law), especially if a franchisor has no control over a franchisee's waste disposal. Exceptions to indemnity would be if a franchisor is liable in a capacity other than as a franchisor, such as the manufacturer of a mandatory product or as a landlord, or if a franchisee is negligent in its operation of the franchised business contrary to a franchisor's required or recommended procedures.

### STANDARD 19.2 CONSENT AND APPROVAL

Wherever a franchisor reserves the right to consent to or approve matters affecting the franchisee, the franchisor should not unreasonably withhold, delay or condition its consent or approval.

**Commentary:** *Proposed by subcommittee (not adopted): It is important to the quality control of the franchise system that the franchisor be able to approve or disapprove various items and acts. When possible, a time frame for approval should be stated in the franchise agreement, and in certain instances (such as the approval of new advertising or a new manager), automatic approval should be granted if a franchisor does not respond. Approval in some instances should be very discretionary (such as the approval of new products and services). The specific procedures for obtaining various types of approvals should be spelled out in the franchise agreement, offering circular, or franchisors operations manual.*

### STANDARD 19.3 FORCE MAJEURE

A franchisor and a franchisee should have mutual force majeure rights.

**Commentary:** The force majeure provision should apply to both a franchisor and a franchisee and should define occurrences that are considered to be within the scope of force majeure.

*(Unanimously approved by vote of 11-1 on 5-1-07)*

## **STANDARD 19.4 INSURANCE**

The franchisor should make reasonable efforts to identify appropriate insurance coverage. A franchisor may require a franchisee to procure and maintain reasonable types and levels of insurance consistent with industry standards. A franchise agreement should require a fair and reasonable allocation of the costs of such coverage. The franchisor may require the franchisee to name the franchisor as an additional insured under the policy.

*(Standard passed 14-2 on October 5, 2004)*

**Commentary:** (to be drafted)