

LEGALINES

Talk is Cheap: What the Franchise Sales Rep Doesn't Want You to Know

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I'll be there for the messy divorce. In fact, I've probably heard your story before. One common scenario sounds something like this: If you had known then what you know now, you never would have signed that franchise agreement. The franchisor's sales representative seemed like a great guy, and he promised you lots of marketing support, great brand awareness, and huge profits. He handed you an overwhelming, 400-page Uniform Franchise Offering Circular and downplayed the importance of that 35-page franchise agreement. Though he acknowledged that the franchise agreement's terms were favorable to the franchisor, he explained that the "technical" language was put in at the insistence of company attorneys. In practice, he assured you, the franchisor would "work with you" to protect your interests – regardless of what the franchise agreement said. Just hurry up and sign on the dotted line so you don't lose this great deal!

Unfortunately, after you signed that franchise agreement and invested enormous sums of money into your new business, the rosy scenario didn't play out. In fact, franchisor support was nearly nonexistent, the public's awareness of the brand was minimal or even negative, and revenues were scarce. Things got so bad that you had difficulty paying your utility bills. Compounding this nightmare was the fact that your monthly franchise fees were based on "gross revenues" rather than profits – meaning that you had to continue paying your unhelpful franchisor even as your business lost money. Over time, it became financially impossible to continue remitting these payments (or to make the costly repairs and facility improvements demanded by your QA inspector).

Now, the franchisor who led your business to ruin is terminating the franchise relationship, suing *you* for breach of contract, and demanding tens or even hundreds of thousands of dollars! Meanwhile, that "great guy" who had made you all the promises at the beginning doesn't remember your discussions with him quite the way you do. You and the franchisor are about to engage in costly litigation.

If this is your scenario, you face an uphill battle. America is a contract-based society, and business owners in this country are usually bound by the contracts they sign. Except in the rarest of circumstances, it doesn't matter that one party was much more powerful than the other or that the contract was extremely one-sided. In fact, a court will usually assume that each party to a contract read and understood it – whether he or she really did or not.

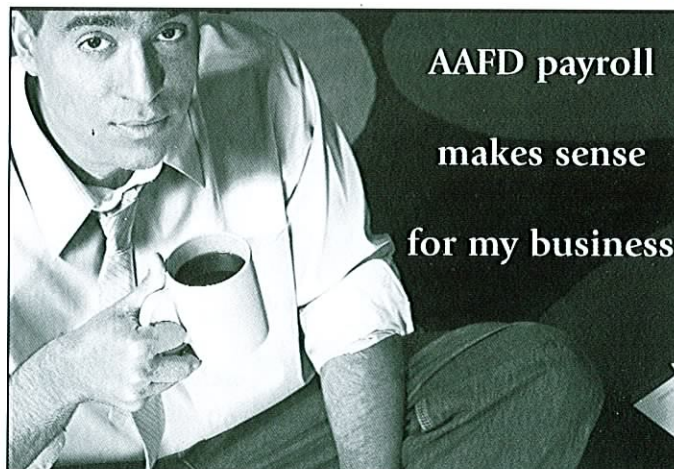
What does this mean for you, the franchisee? Quite a bit, actually. Established franchisors are usually infinitely more powerful than the franchisees with whom they contract. In fact, the franchise agreement and the Uniform Offering Circular that the franchisee relies upon for protection are written by and for the franchisor, whose main goal (understandably) is to protect its own interests. A "well-written" franchise agreement, from the franchisor's perspective, will clearly and exhaustively spell out the franchisee's many obligations while committing the franchisor to relatively little. Further, the franchisor presumably has read and fully understands its own agreement. The same cannot be said for the typical, unrepresented franchisee.

Here's one *very* important thing that the franchisor understands

about its own franchise agreement: that document, like most well-drafted contracts, contains an "integration clause," or "merger clause." When you sign a franchise agreement that has an integration clause, you are effectively agreeing that the only promises that are binding on the franchisor are the ones specifically mentioned in the document. For example, one prominent franchisor requires its franchisees to agree that "[t]here are no express or implied covenants or warranties, oral or written, between [the franchisor and franchisee] *except as expressly stated in this Agreement.*" (Emphasis added.) That same franchise agreement *also* contains this clause: "This Agreement, together with the exhibits and schedules attached, is the entire agreement *superseding all previous oral or written representations, agreements and understandings of the parties.*" (Emphasis added.) If you don't know to look for them, these clauses are easy to miss in a large franchise agreement.

Unfortunately, some franchisor sales representatives are able to use the integration clause as a shield for fraud. That "great guy" who made promises of franchisor support and monetary success probably received a hefty commission from the sale. Further, he most likely knew that the franchise agreement *itself* contains no such promises – and that, by signing it, you were inadvertently agreeing that his words were meaningless. Of course, you can raise his fraudulent behavior as a defense (and a counterclaim) in the litigation, but fraud based on oral promises is extremely difficult to prove. Don't expect the sales representative to admit under oath that he promised you *anything*.

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Final Vote on Small-Business Health Plans Bill Blocked in Senate

On May 11, 2006, legislation permitting small businesses to band together through trade associations like the AAFD to buy cheaper health insurance was shelved after Republican sponsors failed to win enough Democratic support to move the bill forward.

A motion to invoke cloture on the bill failed 55-43, short of the 60-vote threshold that was needed.

Senate Health, Education, Labor and Pensions Chairman Enzi, the bill's sponsor, decried the resistance from Democrats, who said the bill would result in inadequate insurance plans. "So we're going to deny small businesses anything until [Democrats] can get them everything," he said.

Sen. Ben Nelson of Nebraska, the bill's co-sponsor, was joined by Sen. Mary Landrieu of Louisiana as the only Democrats to join with Republicans on the vote. Sen. Lincoln Chafee of Rhode Island was the only Republican to oppose cloture.

The bill would have allowed insurers to offer plans across state lines, creating bigger insurance pools and bypassing many state regulations that apply to existing plans. Sponsors say the bill would lower

costs and increase the number of insured workers.

But critics contend that allowing insurance companies to bypass many state mandates would result in plans that do not cover key services required by state regulations, like mammography services or diabetes care. The legislation was opposed by a consortium of state attorney's general.

Democrats remained largely opposed to the bill, and as of Thursday afternoon Enzi told a group of supporters that he remained "four or five" votes shy of the 60 needed to move to a final vote on his bill.

The Enzi bill was widely considered one of Republicans' best chances of enacting major healthcare legislation this year. It was a revamped version of legislation establishing "association health plans" that has previously cleared the House but stalled in the Senate.

The AAFD joined a consortium of small business associations led by the National Federation of Independent Businesses, and including the International Franchise Association. Supporters of the Bill delivered 450,000 petitions and 40,000 calls and letters in recent days, urging the Senate to enact SBHPs. Small-business owners have been looking forward to this vote since the House first passed similar legislation in 1995. ■

Letter from the President: The AAFD on the Move

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One of the highlights of the conference for me was the record number of franchise owner associations that were in attendance and more importantly their enthusiasm for the opportunity to share ideas with each other. As noted above, an important goal of the AAFD is provide a sense of "home" for franchisee associations that is recognized as the "place to be" and that will entice all associations to join as members. One message that was clearly

received was that the owner association participants particularly valued the opportunity to share "best practices" with each other. Look for this segment to grow in importance and stature in future meetings!

Again, thank you to all who helped make this our most successful conference ever. You have truly "raised the bar" for us for future events, but we look forward to accepting the challenge. ■

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The good news is that winning is not impossible. As demonstrated in *Learning Centers of Central Florida v. Knowledge Points Development Corp.*, a recent arbitration case in Florida, courts and arbitrators occasionally "get it." In *Learning Centers*, the arbitration panel found that a franchisor had made inaccurate oral and written earnings claims in the course of selling two franchises. Not only did the panel effectively nullify the franchise agreements, but it also awarded the franchisee significant monetary damages under an applicable state statute. On the other hand, franchisee victories such as this one are not the norm and come at great expense.

So be forewarned. I'm not suggesting that all franchise sales representatives are shady or that franchise relationships are inherently harmful to franchisees. Many sales representatives are scrupulously honest, and a franchise, when delivered as advertised,

is a dynamic model that can serve *everyone's* interests. What I *am* suggesting is that, when seeking a franchise, you should accept the sales pitch for what it is. Listen to what the representative tells you, but also be diligent in your independent research. Learn about the brand and its appropriateness to your geographic region, have a CPA review the financial portion of the Offering Circular, and talk to some of the franchisor's existing franchisees to gauge their satisfaction. And have an experienced franchise attorney review the Offering Circular and franchise agreement to see what each party's legal obligations *really* are. As I said, I'll be there for the messy divorce if and when it happens. But I'll be wishing you had spoken to me during the courtship.

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Association Best Practices: Communicating ...

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franchisee/franchisor relations to a place where we can once again feel good about recommending the franchise to interested prospects—essential to get the franchise on a strong growth track. Those stores that answer this call of support will be recognized as stores that care not only about themselves, but about the future of

the franchise and their fellow franchisees.

We submit this plea, grateful to those already committed to the AAFD and hopeful that we'll see most stores as members before month's end.

*This letter has been edited to preserve confidentiality of the author. ■