COMPETING BRANDS UNDER COMMON OWNERSHIP

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I. INTRODUCTION

In the first several decades of franchising, franchise companies were owned by entrepreneurs who used franchising as a method of expanding their brand. Some companies, like McDonald’s, grew quite large, but continued to operate only a single brand. In other cases, such as Burger King, the franchise system was acquired by a larger company (in that case, initially by Pillsbury), but the acquiring company continued to operate only a single franchise system. Over the last two decades, this model has changed dramatically. Today, it is not unusual for companies to own multiple brands, some of which may be competing brands, and to offer franchises for each of them.

Some of the companies owning multiple brands operate all of them in the same industry, distinguishing their offerings by brand name, price and amenities. The hotel companies were among the first of this new generation of franchisors. For example, as of this writing, Marriott International, Inc. operates 18 brands – Ritz-Carlton, BVLGARI Hotel & Resort, JW Marriott, EDITION, Autograph Collection Hotels, Renaissance Hotels, AC Hotels by Marriott, Marriott Hotels, Courtyard by Marriott, SpringHill Suites by Marriott, Fairfield Inn & Suites by Marriott, Residence Inn by Marriott, Towne Place Suites by Marriott, Marriott Executive Apartments, Gaylord Hotels, Protea, Moxy, and Marriott Vacation Club. In the 1990s, Hospitality Franchise Systems, Inc. (later becoming HFS, Inc.), acquired multiple real estate franchise systems. Today, Avis Budget Group owns both the Avis and Budget rental car systems, and Driven Brands, owner of Meineke Car Care Center and other automotive brands, bought a regional based car care system, Merlin 200,000 Mile this February. In addition, a number of restaurant operators offer franchises for systems featuring substantially the same core products.

It is also common today for franchise companies to own multiple brands in a single industry, even when those brands do not offer the same core products. International Dairy Queen, Inc., was one of the first companies to do so, acquiring the Orange Julius and KarmelKorn brands in 1987. Today, there are a number of these companies, including the employer of one of the authors of this paper, Kahala Franchising, LLC, which owns 15 brands in the quick service food industry, including America’s Taco Shop, Samurai Sam’s Teriyaki Grill, Kahala Coffee Traders, Great Steak, Pizza Fresh Take-n-Bake, Surf City Squeeze, NqGize Lifestyle Café, Johnnie’s New York Pizzeria, Ranch One Chicken Made Fresh, Frullati Café & Bakery, Rollerz Rolled Sandwiches, Cereality Cereal Bar & Café, Cold Stone Creamery, Blimpie Subs and Taco Time. These companies found that many of the systems and best practices they had developed for one brand could be transferred to another brand in the same industry.

In more recent years, private equity companies have emerged and recognized that the transferability of this know-how extended beyond the same industry. For example, Roark Capital Group, which acquired Focus Brands last year (franchisor of several brands in the quick service restaurant space) also owns a controlling interest in over 25 brands, including companies as diverse as Massage Envy, Bosley’s (pet wellness and nutrition), Corner Bakery (fast casual restaurants), Primrose Schools, Waste Pro (waste collection services), Money Mailer, Batteries + Bulbs, Home Service Store (home improvement project company), Arby’s and Quala (sustainable container solutions).

Among the things the authors learned in preparing this paper is that of all the companies that operate multiple brands, no two operate in the same manner. Some owners maintain
complete independence between brands. YUM! Brands, which owns the Taco Bell, Pizza Hut and KFC brands is an example. Others maintain independence between the brands, with separate personnel and separate offices, but share some board-level oversight. Roark Capital is closer to this example. There are also brands, such as The Medicine Shoppe and Medicap Pharmacies, that not only have a common owner, but have one set of employees operating both brands with the same agreements and standards. In between lies every other multi-brand owner. Presumably, each company is satisfied with its model. Thus, while this paper will not conclude that one method of operation is superior to another, it will address some of the benefits and challenges that characterize common ownership of competing brands.

II. OVERVIEW OF DIFFERENT MODELS. SOME HAVE COMPLETE SEPARATION; MANY SHARE RESOURCES.

A. Factors To Consider

There are various factors to take into consideration when a company owning multiple brands determines whether to share resources or to keep them separate. The factors often start with the size of each of the brands, in terms of revenue, number of locations, number of franchisees, and advertising funds. A larger brand is more likely to be operated separate from other brands owned by the franchisor. The demands of the brands are likely to be more taxing on the franchisor's personnel. A larger brand can also "afford" to operate as a completely separate unit from the other brands, whereas a smaller brand may need to leverage resources of the other brands in order to survive.

Another factor to consider is how the ownership of the brand came to be – was it acquired or developed by the franchisor? An acquired brand will have existing personnel and a history. It is more likely to continue to be operated post-acquisition as a separate unit, with separate personnel, in order to maintain consistency, at least initially. A newly developed brand is more likely to leverage the resources of the existing brands in order to grow organically and save on costs.

A third factor is whether the various brands are in fact in direct competition with one another. Two competing brands owned by the same franchisor are more likely to be run separately in order to maintain their integrity and to preserve the confidence of the franchisees. Two brands that may be in the same industry but do not directly compete (such as two quick service restaurants that offer different food types) are more likely to share resources in order to gain efficiencies.

A thorough analysis must be done by the franchisor, to determine which and whether resources can be leveraged and shared, or whether doing so will harm either brand. Moreover, while the decision to share resources or silo them lies solely with the franchisor, a conversation and transparency with franchisees, especially in the case of an acquisition, may be critical in the long and short term in building the brands and relationships with franchisees.

B. Which Internal Resources Are Typically Shared?

One benefit that a company owning multiple brands in the same industry has is the ability to leverage the relationships and resources of each brand. While this may seem to be a "slam dunk" benefit of common ownership of multiple brands, as will be pointed out throughout this paper, there are numerous pitfalls involved in simply combining functions of various franchise companies, particularly those of competing systems. Issues arise relating to conflicts
of interest, breach of confidentiality, brand loyalty, operational brand knowledge, customer loyalty and franchisee perspective of the franchisor. Moreover, there is no right or wrong way to operate a business, and what works for one brand may not necessarily work for another.

Nevertheless, when franchise brands have a common owner, there will be numerous resources that can be shared. Internal resources, in particular, can be leveraged to provide efficiency and reduction in cost to franchisees. The most typical are accounting, legal, IT, and senior executives or board leadership (although each brand will typically have its own president and senior management). Depending on the similarity of the businesses, purchasing and distribution, research and development, risk management, creative, and construction teams can also be spread effectively over multiple brands.

C. Which Resources Are Typically Siloed?

While some franchisors will typically leverage some resources, other franchisors prefer to separately operate each brand as its own company, even though under common ownership. Neither model is better than the other. However, even franchisors that choose to leverage certain internal resources will concede that certain resources cannot be leveraged as easily as those mentioned in the previous section. For example, a franchisor will want to ensure that its operations team is familiar with all the intricacies of a particular brand in order to best support the franchisees in that system. Therefore, operational support is typically brand specific. Certain aspects of training may be shared, such as general business training (i.e. personnel management, bookkeeping and accounting, and general business operations), product receiving methods and, in a restaurant, food handling procedures. However, training specific to the operation of a brand will typically be siloed. It is also generally beneficial to have dedicated franchise sales and brand marketing personnel for each brand. Smaller brands may initially share the same sales team and even marketing manager, but, as discussed below, ultimately, a full time focus by brand sales and marketing personnel in the bigger brands is integral to their growth and success.

III. ACHIEVING EFFICIENCIES; OPPORTUNITIES AND SAMPLE PRACTICES

A. Brand Marketing And Promotion

It would be unusual in larger systems for two brands to have the same marketing department, or to share the same advertising and promotions. The size of the system alone would dictate having dedicated marketing personnel to support the brand. Add to that the expectations of the franchisees and a franchisor may be required to have multiple personnel exclusively dedicated to the marketing and promotional needs of a larger system. However, when an existing company develops a new brand or acquires a smaller system, the marketing personnel of the original brand will often assist in the kickoff and growth of the new brand. The experience of the more mature brand and its personnel can easily be leveraged by the franchisor without risk to the existing brand, especially if the new or smaller brand is not a direct competitor. The larger brand will have best practices (and sometimes failures) that can be adapted to (or avoided by) a new or smaller brand.

There may also be situations where there is synergy between brands, and in those circumstances, cross promotions can benefit both brands. This can take the form of a joint promotion of products of compatible, but non-competing brands (have dinner at our Burger Barn restaurant, and dessert at our Yogurt World shop), or a coupon offered at one location for the brand of the other. As long as these promotions are designed to benefit both systems,
franchisees of both systems should favor having the ability to offer such unique product ties. This type of cross promotion should not be confused with co-branding as it is not intended to result in one brand offering the products of the other, but merely in sharing the buying power of the consumer.

One challenge in trying to promote products between brands relates to store locations. Using the example above, is a Yogurt World shop close enough to a Burger Barn for it to make sense to the consumer to buy at one and get a coupon for the other? Careful consideration must be given by the franchisor when considering this type of cross promotion and an analysis must be made as to whether there are enough locations of each brand within the same geographic region to warrant the efforts and costs of the cross promotion.

Another challenge concerns the use of advertising/marketing funds collected from the different brands. Can and should they be shared between brands? Franchisee advocates will maintain that the collection of these funds creates a quasi-fiduciary obligation on the franchisor to ensure that the funds are used for the promotion of the brand from whose franchisees the funds were collected. On the other hand, if, for example, one 30-second commercial can just as effectively promote two brands as it could a single brand, then everyone benefits from having each brand pay only half the cost of the commercial. Where such arrangements are desirable, the franchise agreements of each brand should be reviewed carefully to be certain they are broad enough to permit expenses to be shared between funds. Moreover, the Franchise Disclosure Documents ("FDD") should be reviewed to be certain that they do not prohibit such use of the funds. Assuming they do not, but are silent on the issue, consideration should still be given to how the disclosures might be broadened to encompass the potential for cross marketing expenditures in the future.

Even when clearly permitted, the use of advertising funds across brands also raises complex issues as to the allocation of expenditures between the brands. If two brands equally share a 30-second commercial, at first glance, it would seem appropriate that they equally share the cost of that commercial. If one brand has 200 units in the markets in which the commercial airs, and one has 50, is an equal sharing still appropriate? These are difficult issues, and a “best practice” might include a discussion with the advisory council of each brand as to these issues.

What about advertising within systems that allow franchisees to co-brand or otherwise open another brand in the same location? Would this give rise to the sharing of advertising funds? Franchisees that do not operate a co-branded location are likely to be hesitant in allowing advertising funds to be used in the promotion of co-branded units. At the same time, with advertising funds used proportionately from all brands for the cost of shared creative services, franchisees will be able to combine artwork from each of the brands to create local advertising for their store. Some franchisors will recognize, in advance, that co-branding units operate differently than single brand units, and they will have separate advertising funds for the co-brand units. However, that will not always be the case. Advertising focusing on the co-branded units is therefore often initiated at a store level, with support from the franchisor in allowing each franchisee (or groups of franchisees in a market) to create co-branded advertisements for their location(s).

The sharing of gift cards can also represent an opportunity to cross-market and share assets between brands. Consumers purchasing a gift card at Carrabba’s Italian Grill, Outback Steakhouse, Bonefish Grill, Roy’s Restaurant, or Fleming’s Prime Steakhouse & Wine Bar will have a gift card they can use in any of those brands. From a franchisee’s perspective, does
that mean a customer of “my” brand is diverted to another brand, or a customer of another brand is introduced to “my” brand?

B. Expanded Product Offerings

There will also be situations where it might be beneficial for franchisees of one system to have available the products of another. In some instances, the addition of the other product offering can introduce a new day part for a brand that may be limited to primarily morning offerings, or evening offerings, and provide a revenue stream to the franchisee in its non-dominant day part. Using the example from above, if the Burger Barn locations have the ability to add frozen yogurt, Burger Barn franchisees might be able to add a new revenue and profit source to their business. Likewise, perhaps there are signature snacks offered in the burger brand that might be easy to add to the yogurt system. In these circumstances, franchisors will have to pay careful attention to the terms of the franchise agreements, and any territory protection granted to existing franchisees that might be violated by the sale of products at these locations. To the extent the products compete with each other, the issue becomes not only one of territorial protection given for products and services sold under the same trademark, but also protection against the sale of competing products and services, irrespective of the name under which they are offered.

Assuming there are no hurdles in the agreements, franchisors will still have to consider whether merely adding products to one brand rises to the extent of being a co-brand, or is it merely adding a cool cart, or snack display, to the existing brand. Will additional signage be required? What type of training will have to be conducted? What impact does the new product offering have on the existing operations or operations manual?

Even in systems where there might be no territorial overlap, and no contractual impediment to offering the products of one brand in outlets of the other, there are still other practical issues to be considered. For example, if the products do not compete in the same market, will there be suppliers in each market that can provide the ingredients to produce the same quality end product for which the brand is known in other markets? If certain ingredients are not available in a market, the issue of maintaining uniformity in a brand becomes problematic. Moreover, if the delivery systems are not the same, the quality of product can be affected; a one-day-old donut sold in a convenience store will not taste or smell like the one baked in the last hour in the donut shop. How will that affect the image of the donut shop brand, something of paramount concern to the franchisor and its franchisees? Perhaps of greater concern, which system will be sued if someone becomes ill from the product, and is that a risk that has been adequately addressed? None of this is intended to suggest that there are not excellent opportunities for multiple brands to be operated under a single umbrella, but quality control issues must be addressed.

A company’s research and development (“R&D”) team will play a significant role when considering new product offerings and quality control. Use of one R&D team for multiple brands can prove to be tricky given that different members of the team may have a different set of culinary or scientific expertise that may not cross over to the other brands. Unlike the legal or accounting departments, which can more easily be leveraged for multiple brands, leveraging the R&D team requires more scrutinization. There exists a higher risk for the accidental disclosure or use of proprietary information or recipes when a member of the R&D team is tasked with supporting more than one brand, especially brands that may be in competition with one another. This risk must be weighed against the cost of engaging a separate R&D team for each brand. A company may task the same R&D team member to support more than one non-competitive
brand, while at the same time not have any one brand supported by more than one R&D team member.

C. Sharing Franchise Sales Resources

Arguably, the sale of a franchise of any brand conflicts with the sale of a franchise for another brand, as both may be competing for the same investment dollars. Nevertheless, there may be benefits to both franchisors and franchisees when certain aspects of the sales process are shared.

1. Sharing Franchise Leads

If a restaurant system seeking franchisees in the Southwest receives leads from the Pacific Northwest, there is no reason those leads cannot be transferred to another brand. Where the two brands operate in the same markets, the issue becomes more challenging. However, it would seem to benefit the prospective franchisee to have options between brands, particularly if one brand is stronger than the other (or, conversely, where one, presumably the “weaker” brand, has more opportunity for expansion than the other). Likewise, if a full-service restaurant franchisor receives a lead from someone with insufficient capital to build a full-service restaurant, but more than sufficient to develop one or more quick-service outlets, everyone benefits by having the lead steered to an investment that is more appropriate for the prospective franchisee.

Franchisors often develop strategies based on geography and demographics to determine which brands strive in which geographic markets. In addition, a brand may have a strong local following in one part of the country, and lack recognition in another, thereby hindering its growth. A franchisor may choose to develop or acquire a brand that competes in the product but would never compete geographically, thereby not threatening the presence of the first, but allowing the franchisor to create or expand the presence for the second. Using these strategies, franchisors can take leads that may not be right for one brand, and match them to another, often competing, brand under the same owner’s control without threatening the integrity of either.

This sharing of leads is particularly important for hotel systems. The majority of new hotels in many systems are conversions from independent locations, or from other brands. If an independent operator seeks to convert its full-service independent hotel to a Hilton hotel, but the facility does not have the amenities required for the Hilton brand, the property owner may appreciate a referral to the Doubletree or Hampton Hotel brand. Likewise, if the franchise license agreement of a long-time Hilton property is expiring, and the property no longer qualifies under the Hilton brand standards, the property may qualify to become a member of the Doubletree or Hampton systems. This allows the franchisee to remain in the same franchise family, benefitting both parties in continuing the longevity of their relationship.

2. Having Salespersons Sell Multiple Brands

Whether or not they share leads, some franchise systems will utilize the salespeople of one brand to sell franchises for one or more of the other brands. This happens more frequently when a franchise company develops a second brand, hoping to capitalize on the techniques they learned through development of the first brand. On the other hand, when companies expand through acquisition of existing brands, there is often a sales system and salespeople in
place, and the franchise owner will typically continue to have separate personnel selling each brand.

One of the benefits of owning multiple brands is that it allows for the presentation of multiple options to prospective franchisees. In those situations, it may be better to have one salesperson talking to the prospect about each brand. As a franchisor, there is really no difference between the franchisor offering multiple alternatives versus multiple franchisors talking to the same prospect. If a potential franchisee is not going to buy one brand, why not offer them another?

Combining sales forces, and having salespeople sell multiple brands, does, however, present numerous challenges. For one, presenting more options to potential franchisees can cause confusion and lead to paralysis by analysis. When both are presented by the same salesperson, the salesperson might favor one brand over the other, and the best prospects may be shifted to the favored brand, either intentionally or inadvertently. If the salesperson has a personal bias against one of the brands, there is a danger of that salesperson disparaging the brand, or creating admissions of inadequacies of the brand, again presumably inadvertently. Do you really want the salesperson of your brand having to testify under oath as to the negative comments he or she made about that brand when trying to close the sale of a franchise for the other brand? Having brand-specific salespeople alleviates these concerns.

Offering multiple brands provides cost savings to the franchisor in areas such as electronic FDD distribution, lead generation, and even franchise compliance training, but if the brands are significantly different, or the offering is different, a salesperson capable of selling one brand may not have the skills to deal with prospects for the other brand. Indeed, prospects looking at major brands with significant market penetration may not be the same as those looking at smaller brands with more potential for the franchisee to acquire multiple sites in a market. In addition, certain brands may be more significant in different geographic and demographic markets and familiarity of the different market may be required in order to effectively sell a brand to a prospect.

D. Targeting the Franchisees Of One System as Prospective Franchisees For The Other System

Although some might perceive direct competition between brands for franchisees as promoting the growth of one brand over the other, single ownership of multiple brands creates synergies that are beneficial not only to the franchisor, but also to the franchisees. It creates growth where there otherwise might be stagnation.

This issue may arise in a number of circumstances. A franchisee operating in its hometown may reach the point where it wants to expand its business, but the brand to which it belongs has no more opportunities in that market. This franchisee may have little interest in opening units in another market. In that situation, the franchisee will either be selling its existing business and moving into one with more opportunity, or it will look to acquire another brand while maintaining its existing affiliation. The reality is that if a franchisee wants to expand by opening another concept, they will seek something that works, so why not have it be a brand that the franchisor already owns? After all, extending the existing relationship between the franchisee and franchisor is beneficial for both parties; they already know who and what they are dealing with and what the expectations will be.
With the rise of large multi-unit operators, sometimes owned by private equity firms, the franchisee may want to grow its portfolio of businesses, but also diversify its holdings. In those circumstances, it will seek a second brand. Once again, why not have it be a brand from the same family? YUM! Brands has made extensive use of this strategy, in developing large multi-unit operators who own combinations of Taco Bell, Pizza Hut and KFC restaurants.

E. Having Suppliers Of One Brand Become Suppliers To The Other

The synergy among multiple brands owned by one company includes relationships with suppliers. In most cases, the synergy can lead to better pricing opportunities for franchisees. In a situation where a smaller system combines with a larger system, the benefits may inure more to the franchisees of the smaller system who would not otherwise have had access to the same products, services and buying discounts. Query whether franchisees of a larger system would have a claim if this buying power benefited a smaller, competing system in their market and led that system to improve their competitive position vis a vis the larger brand.

If done properly, the leveraging of supply relationships, including potentially allowing suppliers of one brand to compete for the business of another, can often bring better service and better pricing to franchisees of both brands. These synergies may even have been a critical factor in the analysis of the acquisition of one brand by another. However, the leverage of supply relationships is not without its challenges. In some cases, taking advantage of these opportunities may require franchisees to accept different payment terms than they received from the previous supplier, or to submit to different payment procedures. There may also be situations where a supplier has exclusive arrangements with a competitor in a particular market, and thus cannot serve every market. These issues need to be explored before assuming that suppliers can be shared among systems. It is also another area where franchisee input, through the respective advisory councils of the brands, can be very helpful, and perhaps more importantly, can help prevent miscommunications among franchisees.

This synergy applies not only to external suppliers of goods and services that may be used or sold in the franchised units, but also to technologies, such as software, website platforms, reservation systems, and social media applications. Care must be taken to assure unique brand standards of one system are not shared with another, but this can often be accomplished by careful training of personnel. Moreover, the true trade secrets in a business are often much more limited than might initially be perceived. Clearly, advertising slogans and recipes are proprietary, but the fact is that many unrelated franchisors have access to the same third-party software programs and technologies. When two systems are owned by the same company, these programs and technologies can often be shared without concern of divulging confidential or proprietary information.

To the extent there is a sharing of third party suppliers, safeguards must be put in place to ensure that trade secrets are not accidentally disclosed to franchisees of a competing brand. However, these safeguards would be no different from those needed when a single supplier serves two competing brands owned by third parties.

IV. LITIGATION ISSUES – CLAIMS BY FRANCHISEES

While franchisors will point to many of the items discussed in the preceding section as benefits to the franchisees in each of the systems they operate, as is the case with many issues in franchising, franchisees may not see the world the same way. Franchisees of one system may be concerned that some of the trade secrets they use, and competitive advantages they
have, will be shared with others in the market, thus diluting their brand. To the extent the franchise systems of a company’s various brands compete with each other, franchisees may not appreciate that “my own company is competing with me.” There is certainly a potential for disputes when these tensions exist.

A. **Existing Case Law**

In part because the concept of one company owning multiple brands, particularly in the same or similar space, is relatively new in the last 25 years, and something that has only picked up steam in the last decade, there are not many reported cases on this issue. There are, however, a few.

1. **Encroachment Claims**

The most common area of dispute among franchisees and companies that operate multiple brands seems to be in the area of territorial rights. In *Auto-Chlor System of Minnesota, Inc. v. JohnsonDiversey,*¹ a group of dealers sued their manufacturer, alleging they had exclusive territory provisions in their contracts that were breached when the manufacturer acquired a competitor who sold virtually identical products as those sold by the plaintiff dealers. This was not a franchise case, and there was no FDD containing any explanation of the rights of the complaining dealers. The court looked to the language of the dealer agreement and found in favor of the manufacturer, holding that the territorial rights granted to the dealers were very specific to products sold under the manufacturer’s registered trademark.²

This issue was considered in a franchise context in *G.I. McDougal, Inc. v. Mail Boxes Etc., Inc.*³ Mail Boxes Etc. franchisees claimed that the exclusivity provisions of their franchise agreements were breached as a result of the operation by the company acquiring the Mail Boxes Etc. system of UPS drop boxes, counters and mailing locations within their territories. In this case, the franchise agreement was broader than the agreement in the *Auto-Chlor System* case, and specifically prohibited the establishment of a business selling similar products or services under a different trade name within the exclusive territories of the franchisees. The question before the court was whether summary judgment should be issued in favor of the franchisor on the issue, and based on the language of the contract, the court refused to grant the motion for summary judgment, concluding there was a triable issue as to whether the acquiring company’s operation or licensing of similar products or services under the UPS name violated the exclusivity provisions in the Mail Boxes Etc. franchise agreements.⁴

Each of these cases involved allegations of breach of contract, and thus the issue turned on the language of the contract. Nevertheless, if the FDD contains language suggesting franchisees will not face competition from other systems owned by the franchisor or its affiliates, one could imagine a claim for breach of the franchise disclosure laws, or Little FTC Acts, arising out of a disclosure that is no longer accurate as a result of changes in the market; i.e., future acquisitions. Of course, that leads to a drafting tip for franchisors; anticipate the future as much

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¹ 328 F. Supp. 2d 980 (D. Minn. 2004).
² Id. at 999–1002.
⁴ Id. at *1–2, *34.
as possible and make clear in the disclosure document that any statements about any matters other than specific provisions of the franchise agreement are based on current facts and could change in the future without notice to franchisees.

2. Sharing Assets

To date, there have been few cases dealing with the sharing of assets between systems. This may be, in part, a result of an early case in which a franchisee was not successful in asserting such claims. In *Clark v. America’s Favorite Chicken Co., et al.*, franchisees of Popeye’s brought suit against America’s Favorite Chicken Co. (“AFC”) after AFC acquired the Church’s Fried Chicken system and combined many of the internal functions. The franchisees challenged the dual marketing strategy of the brands under a number of theories, including breach of contract, breach of the implied duty of good faith, and violation of Little FTC Acts. The court held in favor of the franchisor on all counts.

This issue was addressed more recently in *Alaska Rent A Car v. Avis Budget Group*. In that case, a number of franchisees entered into a settlement agreement with Avis, arising out of the initial acquisition by Avis of the Agency Rent-A-Car system. Apparently, at the time of the acquisition, there was concern among these franchisees as to the redirection of Avis assets following the acquisition, and the settlement agreement provided that Avis would not use the same personnel to sell and market both Avis and Agency Rent-A-Car vehicles. When Avis subsequently purchased Budget, the plaintiff claimed that Avis breached the settlement agreement by combining many of the operations of the Avis and Budget systems. The lower court awarded a judgment of $16 million in favor of the franchisee, and the award was upheld by the Ninth Circuit Court of Appeals. However, this case may be unique in that the award was based not on a breach of the franchise agreement, but the breach of a specific settlement agreement that apparently discussed the use of the employees at one system in the operation of the other.

B. Other Legal Theories

To date, the other cases that have addressed the ownership of multiple brands by a single company generally revolved around the acquisition of the second brand, which is beyond the scope of this paper. Some of the legal theories advanced in those cases may, however, still be predictive of the legal theories that will be advanced in future cases.

1. Tortious Interference Claims

Might there be situations where the operation of one brand interferes with the operation of the other? One could imagine a situation where a larger system takes advantage of supply relationships available to a smaller system. If the supplier ultimately stops doing business with the smaller system, is there a viable interference claim? Likewise, if a franchisee of one system is negotiating for a site, and this information is known to the parent company, which makes that information known to its other brands, is there a potential for a claim of tortious interference with the negotiations with the landlord?

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6 709 F.3d 872 (9th Cir. 2013).
2. **Unfair Competition**

To the extent a company shares best practices information between brands, is there a potential for an unfair competition claim against either the disclosing company or the one receiving information? The franchise agreement will typically prohibit franchisees from sharing confidential information about the brand, but there is not usually a similar prohibition on the franchisor. Thus, a franchisee would not likely have a breach of contract claim for disclosure of information between brands. However, there are state statutes that provide broad protection against unfair and deceptive trade practices. Would franchisees of System A have a claim under these statutes if System A shares its trade secrets with its sister company, System B, and System B uses those secrets in competition with franchisees of System A? There do not appear to be any reported cases on this issue, but one could envision franchisees of System A asserting the claim.

3. **Antitrust Claims**

If the trend of consolidation continues, there may come a point when companies owning multiple brands in a particular industry will have to be concerned about potential monopoly claims. A number of acquisitions that occur today are already subject to a Hart-Scott-Rodino filing requirement, as the current threshold for these filings is $75.9 million.

4. **Breach of Contract**

One can certainly envision a number of situations in which the operation of a franchise system following an acquisition might result in a breach of older contracts that the franchisor has with its franchisees. This would be particularly true if the original contract did not contemplate an acquiring company imposing extensive changes in the system, or requiring conversion from one brand to another. Even when specific provisions of the contracts are not breached, if the contracts do not clearly permit the permitted action, there is the potential for claims alleging breach of the implied covenant of good faith and fair dealing. These questions must remain unanswered as yet. However, a franchisor considering multiple brand ownership would be wise to contemplate the possible impact of these and other potential legal theories.

V. **SPECIFIC ISSUES IN ACQUIRING A COMPETING CONCEPT**

A. **Franchisee Concerns – They May Now Be Competing With Their Mortal Enemy**

In the early 1970s, an entrepreneur in Southern California, and one in Kansas City, came upon the idea of taking local real estate brokerages, and turning them into a nationally affiliated company. Thus, Century 21 and Electronic Realty Associates (later, ERA) were born. For a quarter century, they competed head to head for franchisees, often accusing the other of tortiously interfering in the other’s contractual relationships. These disputes eventually resulted in litigation between the two systems. In *Heavener, Ogier Services, Inc. v. R.W. Florida Region, Inc., and R.W. Florida, Inc.*, 418 So. 2d 1074 (Fla. Dist. Ct. App. 5th Dist. 1982), a Florida

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7 See e.g., Connecticut Unfair Trade Practices Act, 42 CONN. GEN. STAT. ¶¶ 42-110a to 111 (LEXIS through 2012 legislation).


9 These disputes eventually resulted in litigation between the two systems. In *Heavener, Ogier Services, Inc. v. R.W. Florida Region, Inc., and R.W. Florida, Inc.*, 418 So. 2d 1074 (Fla. Dist. Ct. App. 5th Dist. 1982), a Florida
head, and the more the systems expanded, the less they seemed to like each other. In 1996,
this “Hatfield-McCoy” feud took a most interesting turn when HFS, Inc., having acquired Century
21 less than a year earlier, acquired ERA in one of the early cases of competing franchise
systems coming under the ownership of one company.

Even when two brands have not competed head to head for decades, franchisees will
often express concern when their franchisor acquires a competing brand. When advising a
franchisor in acquiring a competing brand, it would seem that transparency would be most
important to franchisees of the existing brand. If a competing brand is for sale, a franchisor will
often approach that purchase with the mindset that if they (the franchisor) do not purchase the
system, someone else would, which would create even more competition in the market.
Therefore, the acquisition of a seemingly competing brand is viewed favorably by the acquiring
company from the standpoint of eliminating competition, but also, from the potential standpoint
of converting those existing competing locations to the acquiring company’s more mature brand.

In these types of acquisitions, franchisees should be reassured that trade secrets will not
be shared across brands, and that both brands can benefit from the success of the other and
the best practices developed by each. Nevertheless, emotional issues, like the fact that a
mortal enemy is now part of the family, should not be ignored or discounted. These negative
emotions can spread like wildfire through the brand and hurt the entire system while the
acquiring company is still working through the operational issues of having acquired a
competing brand and how to integrate it into the existing system.

An acquiring company must also not forget potential franchisees that may have already
been disclosed and to whom the acquisition of a competing brand may be material. Unless the
franchisor is ready to disclose the transaction (a subject beyond the scope of this paper), the
franchisor may consider halting all sales efforts until the acquisition is complete.

B. Customer Concerns

Public perception may also be a factor for an acquiring company to consider, specifically
when acquiring a “local” or “niche” business that has a strong presence in a particular
geographic region. Social media has fueled the growth of some of these brands, but social
media can be a double-edged sword. Acquisition of a local brand by a national system,
particularly one that sells the same products or services, may lead to concerns that the local
brand will be replaced by the larger brand, or that the smaller brand will lose its cache as it is
expanded nationally. This dissatisfaction can spread almost instantaneously through social
media, and result in a form of “boycotting” in favor of other, local, “mom and pop” type stores,
unless the acquiring company can convince the public that the features of the brand that made
the brand a “favorite son” in a particular region will survive.

C. Due Diligence Issues

The due diligence required in acquiring a competing brand is more extensive than for an
acquisition of a franchise brand in an unrelated field. Not only must the contracts of the target
company be considered, but those of the currently owned competing companies must also be

Court of Appeals upheld the issuance of a preliminary injunction in favor of a Century 21 master franchisee,
prohibiting an ERA master franchisee from soliciting Century 21 brokers to convert to the ERA system. One of
the authors of this paper served as outside counsel to ERA for the decade between 1985 and 1995, and both
wrote and responded to tortious interference accusations nearly annually.
reviewed to assure the acquisition does not breach those agreements. This includes contracts with existing franchisees (in particular, for territory and encroachment issues, but also for any concerns regarding the disclosure of information and sharing of resources). It also includes contracts with suppliers. Many supplier agreements list the sale of the brand as grounds for immediate termination, which clause, if exercised, may undermine and hinder the franchisor’s analysis with respect to the supply chain synergies discussed above.

A discussion of due diligence in acquisitions is beyond the scope of this paper. It is also a concern that extends beyond the legal documents. Do the two brands have competing store development plans, or competing consumer marketing plans such that the growth of one brand will adversely affect the future of the other? These plans would not only be of concern to franchisees, but they are issues that the acquiring brand’s investors and lenders would certainly want to fully understand.

VI. DISCLOSURE ISSUES WITH MULTIPLE BRANDS

Franchisors operating multiple brands, or owned by companies that operate multiple brands, face a number of challenges in preparing their disclosure documents. Consideration must be given to disclosure of one or more of the other brands in more than one-third of the disclosure items under the Federal Trade Commission’s Amended Franchise Rule (the “Amended Rule”).

A. Item 1 – Affiliates

Item 1 requires disclosure of not only the franchisor and its parent companies, but also “any affiliates that offer franchises in any line of business” (or affiliates that provide products or services to the franchisees of the franchisor). Thus, Item 1 requires disclosure of the name and principal business address of each franchise entity that is under common control with the franchisor. In addition, the prior business experience of these affiliates must be disclosed. If the affiliates offer franchises in the same “line of business” as the franchisor, then this prior business experience includes the length of time each has conducted the business that the franchisee will operate, and the length of time it has offered franchises for those businesses. If these affiliates offer franchises in other lines of business, then the franchisor must provide a description of each other line of business, the number of franchises sold in each other line of business, and the length of time each company has offered franchises in each of the lines of business.

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11 ¶ 436.5(a)(1). An affiliate is any entity controlled by, controlling, or under common control with, another entity.

12 ¶ 436.5(a)(7).

13 ¶ 436.5(a)(i)-(ii).

14 ¶ 436.5(a)(iii).
B. Item 2 – Officers and Directors

Item 2 requires disclosure of the name and position of the franchisor’s directors, trustees, general partners, principal officers, and any other individuals who will have management responsibility relating to the sale or operation of the franchises being offered. The principal positions and employers of each person must be listed for the last five years. Consider people who serve as directors or officers of multiple brands. They must be disclosed in the FDD of each brand for which they serve as a director or principal officer. However, does their affiliation in Company A have to be disclosed in the FDD for Company B? The answer would seem to depend upon the person’s “principal” positions and employers during the past five years. In general, directorships of other companies are not required to be disclosed and that would seem to apply to affiliated franchise companies. On the other hand, if a person served, for example, as a director of Franchise Company A, but was principally employed as an officer of Franchise Company B, the FDD for Franchise Company B would only require disclosure of the officer position held in Franchise Company B, but the FDD for Franchise Company A would require the disclosure of the positions with both companies.

C. Item 3 – Affiliate Litigation

Ordinarily, litigation disclosures are required only with respect to litigation of the franchisor and any affiliate that offers franchises under the franchisor’s principal trademark. However, if a parent or affiliate of the franchisor promises to back the franchisor financially, or guarantees a franchisor’s performance to franchisees, then the litigation of that entity must also be disclosed. Thus, by way of example, if an existing franchise company starts a new system, operating under another name, but the existing company is either a parent or affiliate (such as a brother-sister company) whose financial statements are used in the FDD of the new system, all of the litigation from Item 3 of the affiliate’s FDD will also have to be included in the FDD of the new franchise system.

D. Item 4 – Affiliate Bankruptcies

The bankruptcy disclosure requirements are perhaps the broadest of all the disclosure requirements with respect to affiliated entities. There is no distinction in the Amended Rule between affiliates who offer franchises for the same brand, affiliates who offer franchises for another brand, and affiliates who have nothing whatsoever to do with any franchise system. Rather, each franchisor must disclose the required bankruptcy information for itself and for every parent, predecessor and affiliate.

E. Item 11 – Shared Programs

The requirements of Item 11 relate only to the specific franchisor that is offering franchises pursuant to the FDD. Nonetheless, to the extent there are shared training programs (or shared training personnel), shared advertising funds, or shared computer systems, there may be overlapping disclosures and possible references to the other system.

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15 ¶ 436.5(b).
16 ¶ 436.5(c)(1).
17 ¶ 436.5(d)(1).
F. Item 12 – Territories

The description of territory rights in Item 12 is not limited to disclosure of the restrictions on the ability of the franchisor to operate other units in the same market or territory, or otherwise sell products or services in the same market or territory, under the same principal trademark as is licensed to the franchisee.\(^\text{15}\) Rather, it extends to the right of the franchisor “or an affiliate” to make sales within the franchisee’s territory of products or services under trademarks different from the ones that will be used by the franchisee.\(^\text{19}\)

In addition, if the franchisor “or an affiliate” operates or franchises a business under a different trademark, and that business “sells or will sell goods or services similar to those the franchisee will offer,” then additional disclosures must be made as to other offerings of the franchisor and its affiliates. These disclosures include a description of the similar goods and services, the different trademark, whether the outlets will be franchisor owned or operated, whether the other franchisor or its franchisees will solicit or accept orders within the franchisee’s territory, the time table for any plan of implementation (if not already implemented), how the franchisor will resolve conflicts between franchisees of each system “regarding territory, customers and franchisor’s support,” the principal business address of the similar business, and, if that business address is the same as that of the franchisor, whether the franchisor “maintains (or plans to maintain)” physically separate offices and training facilities for the similar competing business.\(^\text{20}\) Note that the Amended Rule does not state that the different outlets must compete with each other in order to require disclosure, but that they “sell goods or services similar to those the franchisee will offer.” However, the Compliance Guide indicates that this disclosure in Item 12 is intended to discuss plans “to operate a competing franchise system offering similar goods or services.”\(^\text{21}\) The explanation of the Compliance Guide therefore seems to limit the disclosure to other brands that will compete with the franchised brand, as opposed to merely selling similar goods or services. Relying on that language, a company that, for example, operates a franchise system operating full-service Mexican restaurants, would not have to disclose that offering, and its effect on territories granted to franchisees for a quick service Mexican restaurant, and vice versa, even though they offer similar items. Of course, a franchisor who decides not to make this disclosure takes the risk that a court will decide that the restaurants do, in fact, compete for customers interested in tacos, burritos and enchiladas, and that, as a result, the additional disclosures should have been made.

G. Item 19 – Financial Performance Representations Based On Affiliates

Franchisors have broad discretion in making financial performance representations, provided they have a reasonable basis and written substantiation for the representation at the time it is made and otherwise comply with the Item 19 disclosure requirements.\(^\text{22}\) Would that

\(^{18}\) ¶ 436.5(l)(6)(A).

\(^{19}\) ¶ 436.5(l)(6)(B).

\(^{20}\) ¶ 436.5(l)(6)(3).


\(^{22}\) ¶ 436.5(l)(6)(S)(3).
allow a franchisor who operates two systems, offering similar goods and services, to use the financial performance of one system in the FDD of another? The Federal Trade Commission ("FTC") has not ruled out the possibility.

In its Frequently Asked Questions (FAQ's), the FTC asked whether the Amended Rule prohibits the use of financial performance representations based upon the results of affiliates.23 The FTC pointed out that all financial performance representations must have a reasonable basis, and advised that when a franchisor has adequate performance data of its own upon which to base a financial performance representation, it would not be reasonable to use the results of an affiliate. However, the FTC also said, “in limited circumstances, a franchisor may base a financial performance claim upon the results of operations of the substantially similar business of an affiliate.” It noted that the franchisor must disclose any characteristics of these outlets that may differ from the outlets being offered for sale. The authors suggest great care be taken when considering using the financial performance of an affiliate, with particular consideration given to whether the affiliate results are, in fact, likely to be indicative of the results a franchisee can expect to achieve.24 Moreover, if numbers from different systems are used, care must be taken to be certain the accounting systems are consistent.

H. Item 20 – Disclosure Of Affiliate Locations

Item 20 requires disclosure of a number of tables related to the status of franchise and company-owned outlets for each of the franchisor’s last three fiscal years. In 2011, the FTC issued an FAQ indicating that disclosures concerning "company-owned units," included not only units owned by this franchisor, “but also affiliate-owned units that are ‘substantially similar’ to the outlets offered by the FDD.”25 The FTC specifically noted that this did not include merely the outlets of the affiliate that conducted business under the same trademark or system, but also outlets that offered goods or services that are “substantially similar” to those sold at the affiliate’s outlets. The FAQ did not say that the particular goods or services had to be sold at a similar price point, or whether these affiliate outlets had to be directly competitive with those of the outlets being offered for sale. However, it did state that the purpose of the Amended Rule was “to include affiliate-owned units that were ‘substantially similar’ to the franchisor’s outlets in the ‘company-owned outlet’ disclosures in Item 20.”26 The FTC continued by stating that the purpose of requiring disclosure of “substantially similar” affiliate outlets, in addition to outlets owned by the franchisor, was to prevent franchisors from hiding negative information. Thus, one might assume that not only must the goods and services offered be similar to the goods and services offered by the franchisee, but that the outlets themselves had to be “substantially similar.” In other words, a company that owned two quick service taco businesses, selling similar products, should be disclosing its company-owned outlets of both systems in the FDD of


24 More guidance in this area may be available in the next year or two as the North American Securities Administrators Association’s Franchise and Business Opportunity Project Group currently has a task force looking into providing further commentary with respect to the preparation of financial performance representations. The use of affiliate information is one of the issues being considered.


each franchise system, but, using the example from above, a company that operated a full service Mexican restaurant concept, offering “substantially similar” products and services as those offered in its quick service Mexican brand, would not necessarily be required to disclose company-owned outlet information of one system in the FDD of the other.

VII. POST-ACQUISITION ISSUES

A. Internal Issues

Many issues can arise post-acquisition. The transition is likely to be much smoother if the acquiring company considers these issues prior to closing the deal. Will the two brands be operated out of separate offices, or will the operations be combined into one office? In the latter situation, there will be numerous internal cultural differences to be considered. This includes such simple matters as the dress code (is the franchisor formal while the target company is casual or business casual?) to more complicated matters such as management styles, lines of authority (who reports to whom), and compensation details varying from compensation methods (some companies pay higher bases, while others have incentive driven systems) to details like car allowances, health insurance plans, retirement benefits, domestic partner benefits, pay days and paid time off.

A thorough analysis of each company’s personnel policies is required in order to ensure a smooth transition. Franchisors may end up cherry-picking the best policies and procedures from either company to implement something completely new, or may require the target company personnel to switch to the existing company’s system, or may even keep certain attributes of each company separate based on the personnel.

When speaking of personnel, communication and transparency to both companies’ employees is critical. Employees are likely to be concerned with redundancies in job descriptions and the security of their positions. Employees of the target company may be required to relocate, but at whose expense? To the extent the employees of the target company will be retained, their benefits packages will need to be reviewed to ensure continuity to the extent possible.

The acquiring franchisor is likely seeking to reduce its general and administrative costs and will take advantage of various economies of scale, while maintaining the value of the nuances of the acquired brand. Accounting methodologies will have to be merged in some instances, which can raise its own set of issues, including methods of expense reimbursement, how payments are calculated to sales personnel, master franchisees and area representatives, how credits are paid or allocated to franchisees (if applicable), and payment terms with suppliers. These are difficult issues to address “on the fly,” and are best considered in advance, with a thorough understanding of the issues to be addressed and a plan in place to address them as soon as the closing occurs.

B. Franchise Issues

Other issues will arise in the franchise context. Some of them have been dealt with in the earlier sections. The importance of having clear and consistent communications with existing franchisees cannot be overemphasized. While the focus of these communications will typically be the franchisees of the newly acquired brand, if that brand is seen as a competitor of an existing brand owned by the franchisor, franchisees of the existing brand should be
reassured that the transaction will, at worst, be neutral to them, and (if true) may result in positive synergies that will benefit franchisees of the existing brand.

Beyond concerns as to the acceptance by existing franchisees of the new relationships, there also may be operational differences that need to be considered. For example, if the acquiring company’s existing franchise system grew without exclusive territories, while the franchisees of the acquired system all have exclusive territories of some type, this is a significant difference that will require different policies for the newly acquired company than for the existing one. In fact, the structure of the franchise systems may be different, with one operating through sub-franchisees, and the other having direct relationships with its franchisees. Even in the latter model, some franchisors developed through single-unit franchise sales, while others grew through the sale of territories to area developers who opened multiple units in a market. These are very different growth models, and a company acquiring a model that is different than that with which it has had experience may suffer an initial culture shock.

There will also likely be legal differences in the franchise agreements of each brand. Differences in dispute resolution techniques, venue, default provisions, and various provisions of the franchise agreement are likely to exist. These are often more than simply differences in contract provisions; they may also reflect a difference in attitude and culture as to the handling of disputes with franchisees. To the extent the acquiring company seeks to combine administrative staffs or even legal departments, decisions will have to be made as to whether it is preferable to stay with the contract provisions, and culture, of the acquired brand, or convert new franchisees of that brand onto the existing brand’s forms and methods, with the ultimate goal of converting all the franchisees to the existing brand’s forms and methods. This process will take significant time and attention. A franchisor will have to closely evaluate the provisions of each contract, and the cultures of the businesses, in order to determine which will be most effective going forward. Consideration should also be given to any state relationship laws that prevent unilateral changes in the competitive circumstances of the franchise.\footnote{See e.g. Wis. Stat. § 135.04 (2009).}

C. Risk Management Issues

There are numerous risk management issues that must be addressed when operating competing systems. These issues arise from internal concerns, and from relationships with franchisees. To the extent a catastrophic event occurs with one brand, be it a consumer issue such as the sale of tainted food, a significant labor issue with one brand, a public relations gaff (does anyone remember the Sambo’s restaurant chain?), or a franchisee revolt, how will these issues affect the other brands? The answer may lie in how closely the brands were operated, public perception, and operating decisions that were made during the course of operating the businesses (such as, for example, whether the financial statements of one brand were used in selling franchises of another brand). These issues should not be ignored. If Brand A is a strong brand, but incurs a multi-million dollar liability as a result of the operation of Brand B, such that it can no longer afford to provide the same services to its own franchisees, both brands become materially and adversely affected by the problems of Brand B.

Some of these issues can be addressed with adequate insurance. To be certain there is not a gap in coverage, there needs to be a careful review of the relevant insurance policies to be certain each brand is properly protected from the various risks that may actually originate from another brand. Public relations problems may be more difficult to address.
D. Antitrust Issues

No paper addressing competing businesses would be complete without at least raising the issue of potential antitrust concerns. A full discussion of antitrust issues is well beyond the scope of this paper, but decisions that affect pricing, tying products or services together, and the nature of agreements with suppliers (particularly exclusive arrangements) all require review by antitrust counsel.

VIII. CONCLUSION

This paper has not attempted to address “best practices” in acquiring or operating competing brands. The reality is that “best practices” will vary from one acquisition to another, depending on a number of factors, including the nature of the competition between the brands, whether the brands will be operated independently or under one umbrella (and geographically, whether they will be operated from the same physical office), the intent of the acquiring company with respect to combining systems and functions of the brands, the culture of the brands, and the contractual provisions that govern the relationship each franchisor has with its franchisees, suppliers and employees. Rather, while we have occasionally suggested some “best practices” that would apply to all companies, our primary focus has been on the issues to be considered, and the importance of analyzing these issues prior to consummation of the transaction. These business issues are often more important than the legal issues that will be encountered in the operation of competing systems, particularly if appropriate due diligence has been done on the legal issues in advance of the acquisition. However, these issues will arise continuously, throughout the life of the franchise systems, as one brand seeks to take advantage of the resources and best practices of the other. Because the concept of common ownership of a competing brand is a relatively new phenomenon, much of the law that will exist on this subject a decade from now is yet to be made.

If readers are to glean one thing from this paper, it should be that the issue of ownership of competing brands by one entity offers significant potential advantages, but involves complex and ongoing challenges. Ironically, these challenges may not even end upon the sale of one of the brands. In Century Pacific, Inc. and Becker Enterprises, Inc. v. Hilton Hotels Corporation, Doubletree Corp. and Red Lion Hotels, Inc.,28 the franchisees of an acquired hotel brand sued the acquiring company not in connection with the acquisition itself, but following the subsequent divestiture of the brand. After more than five years of litigation, the franchisor prevailed, but the lesson remains that the concerns of franchisees of an acquired brand begin in anticipation of an acquisition, will often continue throughout the relationship, and may even continue following divestiture of the brand. It is best that these concerns not be ignored.

4820-6799-1835, v. 7

28 354 Fed. Appx. 496 (2d Cir. 2009).
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Chuck is a former member of the Governing Committee of the American Bar Association’s Forum on Franchising, and served as the Forum’s Finance Officer for nearly seven years. He has also been active in the IFA for over three decades, having served on the Legal/Legislative Committee, the Franchise Relations Committee, and the Board of the Council of Franchise Suppliers. He is a member of the Advisory Committee to the North American Securities Administration Association Franchise and Business Opportunity Project Group which meets regularly with state franchise regulators from across the country. Chuck is recognized as a leader in the franchise field by Chambers USA, Best Lawyers in America,® Who’s Who of International Franchise Lawyers and Super Lawyers.® He served on the Larkin Hoffman Board of Directors for more than ten years, and as the firm’s Chief Financial Officer. He received a Bachelor of Science degree from the University of Florida in 1974 and graduated with high honors from the University of Florida College of Law in 1977.
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