Message from the Chair
By Joseph J. Fittante
Forum Chair

As my term as the Chair of the Forum draws to a close, I want to thank you for your support and encouragement over the last two years. It has been my highest privilege and greatest honor to serve as the Chair of the “preeminent forum for the study and discussion of the legal aspects of franchising.” It is a position that demands a great deal of time, effort and attention, but I am happy to report that the benefits of working with great people, building lasting relationships and being a part of a team that has navigated some rough waters to put the Forum on a course for future growth, far outweighs the challenges of the position.

Speaking of teamwork, I would be remiss if I did not mention the extraordinary efforts of Diane Green-Kelly and Eric Karp, the co-program chairs of the upcoming October Forum. Faced with the challenge of having to educate not one but two ABA representatives on the ins and outs of our Annual Meeting, Diane and Eric have done an amazing job in planning what I am sure will be the legal event of the year when it comes to franchising. Set for October 16 to 18 at Rosen Shingle Creek Resort in Orlando, Florida this year’s Annual Forum promises to live up to the high bar set by prior programs. Diane and Eric have added a couple of new twists to this year’s event, while keeping the traditional Forum favorites. Highlights of the upcoming event include a Wednesday program on the fundamentals of international franchising, which includes a networking dinner for attendees the night before, as well as 24 workshops addressing many of the hottest legal issues in franchising. The networking events planned by Diane and Eric promise to bring out the kid in all of us with the Thursday night festivities planned for the Wizarding World of Harry Potter at Universal Studios, followed by a Friday night beach party to be held at Discovery Cove, a part of Sea World. Admission to some of these events is limited. Sign up now to guarantee your spot.

At the beginning of this column, I mentioned the great people I have had the honor of working with during my term as the Chair of the Forum. Many of these people will continue on after my term ends, leading the Forum into its 37th year and beyond. To that end, I am happy to report to you that the current Forum leadership roster is deep, and marked by unique experiences resulting in a diversity of opinion and thought; two of the most important attributes of any successful organization.

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Gift Card “Breakage” – Careful Planning Required

By Daniel R. Garner
Greensfelder, Hemker & Gale, P.C. (St. Louis office)

Introduction
It’s the thought that counts, right?

Despite the fact that gift cards have become the gift of choice for an ever growing number of consumers, such cards often go unused. Whether it is the well meaning but forgetful co-worker who gives a gift card for a butcher shop to a vegan colleague or merely Grandpa Joe who forgets about your thoughtful gift of a mall gift card, the simple truth is that many gift cards will never be redeemed.

Recent estimates suggest that anywhere from 6-10% of all gift card sales never result in redemption. The Chicago Daily Herald recently quoted data and estimates from research company CEB TowerGroup that an astonishing $1.7 billion of the $110 billion gift cards purchased in 2012 will go unused. NPR even reported in late 2011 (citing TowerGroup data) that $41 billion in gift cards have gone unredeemed since 2005.

Although the use of gift cards has become commonplace, most consumers (and likely many franchisors and franchisees as well) misunderstand what actually happens to the unused funds on those cards. Most assume the unused funds automatically become a windfall profit (the industry term is “breakage”) to the issuer of the cards. But that is not necessarily true. Instead, contrary to public perception, absent careful planning, neither the issuing franchisor nor the retailer/franchisee is likely to receive any breakage at all.

Gift cards would, at first blush, seem a perfect fit for large retail franchise systems. Ideally, gift cards can strengthen the franchised brand and identity, and encourage consumers to patronize units across the system. Further, the franchisor/issuer may use the gift card breakage to fund the program, or to otherwise support the brand and system. Unless properly designed, however, a gift card program may cause more grief than it is worth.

Applicable Law
The Treasury Department’s regulations governing gift cards and loyalty programs (called Regulation E, 12 C.F.R. Part 205) became effective in August 2010. Under Regulation E, gift cards cannot expire for at least five years (with few exceptions). In addition, states have since passed similar gift card laws, some of which entirely prohibit expiration dates. Because gift cards cannot expire for at least five years, there should be, in theory, some reduction in breakage simply because consumers have more time to use the cards. Most clients tell me, however, that so far, the trend continues that if a gift card has not been redeemed after two or three years, there is almost no chance it will ever be redeemed, regardless of when the card expires.

More importantly, most states have unclaimed property laws (also known as escheat laws) that require issuers to transfer the funds on unredeemed cards to the state rather than to their own bottom line. Theoretically, the state holds the unclaimed funds with the intent of reuniting them with the rightful owner, but some states actually use escheated funds to ease budget deficits. (See e.g., Michael Smerconish, The Pulse: Don’t let those gift cards be a gift to retailers or the state, Philly.com, Jan. 6, 2012, http://articles.philly.com/2012-01-06/news/30598028_1_gift-cards-certificates-credit-card-accountability.) Either way, these escheat laws can potentially eliminate breakage entirely.

Because gift card expiration and escheat laws can reduce or even eliminate breakage, it has become increasingly difficult for gift card issuers (such as franchisors) to distribute breakage. Worse yet, significant liability looms for issuers who do so in violation of law. Thus, it is critically important for issuers, including franchisors, to design their gift card programs to ensure that, to the extent breakage exists, the issuer can retain and distribute it as desired. The following guidelines provide a roadmap for a franchisor’s consideration of gift card breakage.

Step 1- Establishing an Expiration Date Policy
At the outset, the issuer should consider whether to allow its gift cards to expire. This is an important decision, because if an issuer “breaks” a gift card that has not expired, there at least some possibility, however remote, that consumers will attempt to redeem the gift card at a later point. Note, this can happen in states that require escheat of unredeemed gift cards as well, as there are several states that classify gift cards as unredeemed property prior to expiration or before five years.
have passed. It is possible – though not yet clear – that Regulation E would consider breakage prior to expiration as a violation and/or would preempt such state escheat laws.

In deciding whether to establish an expiration policy, the issuer should consider a number of issues. First, the expiration policy must comply with Regulation E, which generally provides that no gift card may expire for at least five years from the date a consumer loads funds to the card, and that the card must properly disclose any expiration date. The penalties for violating these expiration or disclosure provisions can be severe, and the possibility of a class action challenging an issuer’s premature gift card expiration further warrants strict compliance with these basic rules.

Second, the expiration policy must comply with state gift card laws, which may vary substantially from state to state. For franchise systems with units in multiple states, this consideration may be particularly complex, because Regulation E expressly provides that it does not preempt any state law that is more protective of consumers. Thus, the franchisor must determine and then comply with the requirements of each state where it or its franchisees sell or accept gift cards for redemption. As a result, there may be situations where a gift card could expire in one state but not in the neighboring state. If there are franchised retailers on both sides of the state line, establishing an expiration date in either state could at least theoretically result in a violation and the possibility of legal challenge. Because of the complicated interaction between Regulation E and state gift card laws, determining whether and how to allow gift cards to expire can be a complex proposition for many franchisors.

Third, the franchisor issuer must determine whether there are other practical considerations that caution against expiration. For example, if the franchise agreement does not detail how breakage will be distributed, expiring gift cards may lead to disputes with the franchisees. Or, a franchisee may wish to alert consumers about impending expiration of branded gift cards or to run an “expired gift card forgiveness” promotion, in the hopes that consumers may remember their unused gift cards and make a return trip to redeem them, which may cause friction with the issuing franchisor. Or, if a franchisor has issued a number of outstanding gift cards prior to Regulation E’s enactment, and those gift cards do not contain an expiration date, there may be further questions about whether to expire the cards. Although unilaterally declaring these pre-existing cards as expired would not violate Regulation E, the gift card owners arguably could assert claims for breach of contract. And of course, for purposes of marketing and consumer goodwill, some franchise systems may simply decide to sell gift cards that never expire.

**Step 2- Analyzing State Escheat Laws**

Under generally accepted accounting principles, revenue from a gift card sale is not actually income until a consumer has redeemed the card or the seller declares the card as “unused.” Although the SEC permits a seller to declare a gift card as unused once it is reasonably likely no one will redeem the card, many states specifically legislate when a card constitutes abandoned property for the purposes of escheat laws and what the issuer must do with the unused funds. Thus, once a franchisor issuer has determined its expiration policy, it must next analyze whether there are state escheat laws that will affect the distribution of the unredeemed funds.

For smaller or localized franchise systems, the analysis of escheat laws often may be relatively simple. With few exceptions, where a franchise sells and accepts gift cards for redemption all within only one state, that state’s escheat law will be the only one it needs to consider.

For franchise systems with franchised retail outlets in multiple states, however, the determination of which state law (or laws) is applicable to its gift card program can be more difficult. Not only are there dozens of states with their own escheat laws that expressly apply to gift cards, but the very nature of gift card sales (initially sold to a customer who will likely give the card as a gift to a third party) will often render it impossible for the franchise to know where a gift card owner lives or where any particular unredeemed gift card is at any given time. In such circumstances, the escheat laws of at least two different states may apply.

Where at least two states have a claim to unredeemed gift cards, federal common law controls the priority of the states’ claims. In [Texas v. New Jersey, 379 U.S. 674, 680-82 (1965)], the Supreme Court established two “priority rules” to resolve any conflict regarding which state is entitled to intangible abandoned property such as unredeemed gift card funds. The first priority – called the “primary rule” – belongs to “the State of the last known address of the creditor, as shown by the debtor’s books and records.” Id. at 682. If the primary rule fails to resolve the conflict because there is no known address for the gift card owner (as is usually the case) or because the gift card owner’s address is in a state that does not escheat abandoned gift cards, then the “secondary rule” provides that the state where the debtor is incorporated triumphs unless another state proves it has superior rights. Id. Consequently, a franchise that
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(a) does not keep records reflecting the residence of the person/entity purchasing the gift card purchaser or owner, and (b) is incorporated in a state that does not escheat unredeemed gift cards will be able to convert the unused funds into breakage.

These priority rules essentially allow a savvy franchisor issuer to “game” the system and keep some of its gift card breakage. For example, many larger companies incorporated in states that escheat gift cards will incorporate a separate entity for issuing its gift cards in a state that does not escheat gift cards. The issuing entity then purposely fails to keep records reflecting the gift card purchaser/owner’s address, and once the gift card expires, the issuer may retain the breakage, creating pure profit on its balance sheet.

Of course, states will likely attempt to limit the ability to avoid escheat. For example, in 2010, New Jersey amended its unclaimed property laws to include a “place of purchase” presumption and required all retailers selling gift cards in New Jersey to maintain records of the purchaser’s last known address. In response, a number of gift card issuers challenged the law. The Third Circuit found that Texas v. New Jersey preempted the attempted alteration of the priority rules, but it upheld the record keeping requirements. New Jersey Retail Merchants As’n v. Sidamon-Eristoff, 669 F.3d 374, 392–98 (3rd Cir. 2012). In response, American Express went so far as to stop selling gift cards in New Jersey entirely to avoid the record-keeping requirements. For the time being, however, with careful planning, some franchises will continue to be able to avoid escheating unredeemed gift cards.

Step 3- Distribution of Breakage
Once an issuer determines it does not have to escheat the unused funds to the state, it can retain or distribute the breakage. If planned carefully, a franchisor may elect to use the program’s breakage to pay for the gift card program or to support the brand and system generally, such as through the purchase of advertising. Alternatively, the franchisor may elect to simply retain the breakage for its own account, or to distribute breakage directly to its franchisees.

Somewhat surprisingly, industry trends suggest that most franchisors have not expressly provided in their standard franchise agreement how they will distribute gift card breakage. Instead, most franchise agreements are either silent about breakage, or they contain only a general provision stating that the franchisee agrees to participate in the franchisor’s gift card program and the franchisor retains the right to account for and distribute all funds. In such cases, the franchisor’s operations manuals may address the issue, or there may be no controlling provision at all. On the other hand, some franchisors have separate gift card agreements with franchisees that specifically govern the terms of the gift card program, often in connection with the franchisor’s operation of a consumer loyalty program that incorporates the issuance of gift cards.

Best practices are far from established. However the breakage is ultimately divided, it is vital that the franchisor closely examine its breakage goals and applicable law before issuing gift cards. Not only could a mistake regarding its expiration policy or escheat laws result in significant legal liabilities, but it could also eliminate the possibility of ever receiving any breakage at all.

As I wrote in my initial Chair’s Message, an organization is only as good as its members. I believed then and still believe today that judged by this measure, the Forum has no peers in the franchise community. With that said, it is the ongoing obligation of leadership to provide each of you with value for your Forum membership dues. Led by Deborah Coldwell, the incoming Chair, I am certain current Forum leadership will continue to satisfy this obligation.

Have a relaxing remainder of the summer. Catch a baseball game if you can. Spend time with your family, and I will see many of you in Orlando.
What Do You Mean I Can’t Renew?

By David L. Steinberg and Jyotsna Balakrishnan
Jaffe Raitt Heuer & Weiss, P.C.

In the excitement of investigating and eventually opening a new franchise business, it is not unusual for a prospective franchisee to “look past” many of the terms and conditions contained in the franchise agreement. It is mostly those prospective franchise buyers who obtain counsel to explain and lead them through the minefield of the FDD, who can reasonably be “sensitized” to the duties, conditions and obligations in their agreement.

In particular, it has been the experience of the authors that until fully advised by counsel, franchise buyers are generally unaware that the franchise agreement contains specific conditions for renewal. In fact, many are surprised (if not shocked) to learn that the right to operate “their business” is not perpetual, but is only for a designated period of time that will expire without renewal unless the franchisee complies with specific conditions identified in the franchise agreement, including payment of a renewal fee.

The range of such conditions is only limited by the imagination of the franchisor’s drafting counsel, as well as the nature of the franchise system.

Execution of a New Agreement

One renewal term that is prevalent in most franchise agreements is the requirement that the franchisee sign what is generally defined as “the then current franchise agreement.” While this definition would seem to be self-explanatory, there have been cases brought seeking clarification. The consensus seems to be, however, that “then current” means the franchise agreement used by the franchisor at the time of renewal, not at the time the franchisee first signed the franchise agreement. G.I. McDougal, Inc. v. Mail Boxes Etc., Inc., No. B226112, 2012 WL 90083, at *8 (Cal. App. 2d, Jan. 12, 2012). Thus, it is imperative that counsel explain to its franchisee client that even if they pay renewal fees, refurbish their site and meet all other stated renewal terms, they will be required to sign a new franchise agreement that may, in fact, be on very different terms and conditions. This concept is foreign to many buyers who contrast their agreements to real estate leases, which are often extended by options permitting the original terms and condition to continue (albeit with certain changes such as rent or other costs).

I Have to Pay Another Fee?

Another common renewal term is payment of a renewal fee. Even though it is required to be stated in Item 6 of the FDD (and most certainly will be in the renewal terms in the franchise agreement), franchisees are often surprised to discover that an additional fee must be paid to “renew” their franchise rights. As a matter of contract law, franchisors certainly have the right to charge a renewal fee (generally either a fixed amount or a percentage of the “then current” franchise fee). The amount and extent of fees vary greatly depending upon corporate culture - some companies view it as another revenue source, others see it as necessary to cover legal and administrative costs that can result, and yet others may charge no fees whatsoever. In most cases, it is the experience of the authors that the amount charged by franchisors for a renewal fee is generally a small percentage of the original fee, revenue from which is used to cover administrative expenses incurred with respect to addressing questions or issues in the new FDD.

Is “Good Cause” Enough to Refuse Renewal?

However, it cannot always be assumed that the franchise agreement renewal provisions are enforceable as written. Eighteen states have statutes or regulations imposing some degree of limitation on a franchisor’s refusal to renew a franchise. While these statutes exist, franchisees should not expect the protection granted by them to be limitless. Most of these regulations are liberal in nature, requiring only that the franchisor demonstrate that it has “good cause” for its decision not to renew. “Good cause” is defined differently under different statutes, but frequently encompasses franchisee’s failure to comply with a term or terms of the franchise agreement or franchisee’s failure to execute the then existing franchise agreement. See G.I. McDougal at *10. Many state laws expressly state that franchisors may require franchisees to agree to then existing policies, practices and standards established by the franchisors, as a condition to renewal of the franchise (e.g., Arkansas, Hawaii, Indiana, Iowa, Nebraska and New Jersey). Yet, in many states, just having “good cause” is not enough to preclude renewal rights. For example, some states require written notice be given within a defined time period (e.g., Arkansas,
California, Connecticut, Illinois, Iowa, Maryland, Minnesota, Mississippi, Missouri and Washington). Other states have some form of purchase or compensation requirement if the franchisee cannot operate a similar business (e.g., Connecticut, Hawaii, Maryland, Michigan, Illinois and Washington). One state has an advance notice requirement and additionally a requirement that the franchisor should have been given the opportunity to operate the franchise over a sufficient period of time to recover its fair market value as a going concern (Minnesota). Wisconsin requires that any substantial change in the competitive circumstances of a franchise agreement cannot be done without good cause.

A summary of state laws affecting renewal are as follows:

**Arkansas** – It is a violation of the Arkansas Franchise Practices Act if a franchisor does not renew a franchise agreement except where the failure to renew is for good cause or in accordance with the current policies, practices and standards established by the franchisor, which in their establishment, operation, or application are not arbitrary or capricious. Ark Code Ann. § 4-72-204(a)(2) (LexisNexis 2013).

**California** – Franchisor may not fail to renew unless 180-day prior written notice is provided, and at least one other specified condition is met, one of them being that franchisor and franchisee fail to agree to changes or additions to terms and conditions of the franchise agreement, if such changes or additions would result in renewal of the franchise agreement on substantially the same terms and conditions on which the franchisor is then customarily granting renewal franchises. Cal. Corp. Code § 20025 (2013).

**Connecticut** – It is a violation of the statute if a franchisor does not renew a franchise except for good cause. The franchisor may elect not to renew a franchise which involves the lease by the franchisor to the franchisee of real property under certain specified circumstances (and upon 6 months’ written notice). Conn. Gen. Stat. § 42-133f (2013).

**Delaware** – It is a violation of the statute if the franchisor fails to renew a franchise without good cause or in bad faith. If there is a lease by the franchisor, renewal terms of the lease have to be reasonable. Del. Code tit. 6, § 2552 (2013).

**Hawaii** – It is a violation of the statute for a franchisor not to renew a franchise except for good cause or in accordance with current terms and standards established by the franchisor. Haw. Rev. Stat. § 482E-6(H) (2013).

**Illinois** – It is a violation of the statute not to renew a franchise agreement without compensating the franchisee if the franchisee is barred from continuing to conduct substantially the same business under another trademark or trade name, or the franchisee has not been sent notice of the franchisor’s intent not to renew the franchise at least 6 months prior to the expiration date or any extension thereof of the franchise. 815 Ill. Comp. Stat. § 705/20 (2013).

**Indiana** – A franchise agreement cannot provide that the agreement is not renewable without good cause or in bad faith, provided that it can provide that the agreement is non-renewable or that it is renewable only if the franchisee meets certain conditions. Ind. Code § 23-2-2.7-1(8) (2013.)

**Iowa** – It is a violation of the statute for a franchisor to refuse to renew a franchise unless 6 months’ prior notice is provided and there is good cause. As a condition of renewal, a franchise agreement may require that the franchisee meet the then current requirements for franchises and execute a new franchise agreement. Iowa Code § 523H.8 (2013).

**Maryland** – A grantor of a franchise has to notify its distributor at least 60 days before non-renewal of a distributor agreement. The requirement to provide prior notice and the repurchase obligations do not apply to a termination of a distributorship at the natural expiration of the specified term of a written contract that does not contemplate renewal options exercisable by either party. Md. Code Ann., Com. Law § 11-1303 (LexisNexis 2013).

**Michigan** – Provisions in the franchise agreement that allow a franchisor not to renew without fairly compensating the franchisee by repurchase, etc. are unenforceable (this provision only applies if the term of the franchise is less than 5 years, and the franchisee is prohibited from continuing substantially the same business under another trademark). Any provision that allows the franchisor to refuse to renew on terms generally available to other franchisees is also prohibited. Mich. Comp. Laws § 445.1527 (2013).

**Minnesota** – A franchise is prohibited from failing to renew a franchise agreement unless the failure to renew is for good cause, the franchisee is given 180 days prior written notice, and the franchisee has been given the opportunity to operate the franchise over a sufficient period of time to recover its fair market value as a going concern. Minn. Stat. § 80C.14 (2013).

**Mississippi** – A franchisor may not fail to renew a franchise agreement without notifying the franchisee of such intention in writing at least 90 days in advance of the failure to renew, except under certain specified circumstances where such advance notice need not be provided (for instance, insolvency of the franchisee). Miss. Code Ann. § 75-24-53 (2013).

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Missouri – A franchisor may not fail to renew a franchise agreement without notifying the franchisee at least ninety 90 days in advance of the failure to renew, except under certain specified circumstances where such advance notice need not be provided (for instance, insolvency of the franchisee). MO. REV. STAT. § 407.405 (2013).

Nebraska – It is a violation of the statute to fail to renew a franchise agreement without giving written notice of such failure to renew at least 60 days before such failure to renew, except under certain specified circumstances where such advance notice need not be provided. Although the statute also provides that it will be a violation to fail to renew a franchise without good cause, it also states that this shall not prohibit a franchisor from providing that the franchise is not renewable or that the franchise is only renewable if the franchisee meets certain reasonable conditions. NEB. REV. STAT. § 87-404 (2013).

New Jersey – It is a violation of the statute to fail to renew a franchise without giving written notice setting forth all the reasons for such non-renewal at least 60 days in advance of such non-renewal, except under certain specified circumstances where such advance notice need not be provided. Although the statute also provides that it will be a violation to fail to renew a franchise without good cause, it also states that good cause for failing to renew a franchise shall be limited to failure by the franchisee to substantially comply with requirements imposed on it by the franchise and other agreements ancillary or collateral thereto. N.J. REV. STAT. § 56:10-5 (2013).

Virginia – It shall be unlawful for a franchisor to cancel a franchise without reasonable cause or to use undue influence to induce a franchisee to surrender any right given to it by any provision contained in the franchise. VA. CODE ANN. § 13.1-564 (LexisNexis 2013).

Washington – It is an unfair or deceptive act or practice, and a violation of the statute to refuse to renew a franchise without fairly compensating the franchisee for the fair market value, at the time of expiration of the franchise, provided that compensation need not be made to a franchisee for goodwill if one year’s notice of non-renewal is provided and the franchisor agrees in writing not to enforce any non-competition covenants in its favor. WASH. REV. CODE § 19.100.180 (2013).

Wisconsin – No grantor may fail to renew or substantially change the competitive circumstances of a dealership agreement without good cause. The burden of proving good cause is on the grantor. WIS. STAT. § 135.03 (2013).

Thus, except for those states regulating “substantial change,” franchisors are legally free to materially change the terms of the franchise relationship upon expiration of the initial term if such terms are substantially similar to that being offered to other franchisees at the time of renewal. The efficacy of doing so can be debated on both sides. Franchisees often argue that failure to renew on the same terms and conditions leaves them susceptible to having the franchisor change material terms of the expiring agreement, such as decreasing or changing the protected territory or charging large renewal fees, as an excuse to make more money. The primary remedy for the franchisee is to argue that such actions demonstrate a lack of good faith, or argue discrimination if such terms are not the same for other franchisees. For example, in Wisconsin, a franchisee may be able to argue that the terms of the new franchise agreement “substantially change the competitive circumstances” without good cause. Still, it’s a tough position to win. In Best’s 33 Flavors Franchising Corp v. Wiskins, 591 F. Supp. 2d 1533 (E.D. Wis. 1994), the court held that an ice cream franchisor’s imposition, upon renewal, of a new standard agreement on a franchisee, requiring substantial additional investment and an increased franchise fee, did not substantially change the franchisee’s competitive circumstances in violation of the Wisconsin Fair Dealership Law since such a claim did not take into account the potential for additional sales and passing on of additional costs to customers. This case illustrates that a franchisor may very well have valid business reasons for not only making changes, but potentially overhauling a franchise system after 10 or 20 years, the result of which may require new terms, conditions and expenditures that otherwise could not be accomplished. While there may be substantial changes, it could also be argued that they were being made in “good faith” for the benefit of the entire franchise system as whole.

In truth, while many of the states that regulate the franchise relationship impose upon franchisors some level of protection for a franchisee desiring to renew, the standards of “good faith,” “notice” and “good cause” are fairly easy for franchisors to meet, essentially eroding the very intent of the state regulations. It is important that franchise counsel fully explain to the client that being licensed to operate a “business format,” is not the same as simply leasing a real estate site, which aside from rental costs dictated by the market, are typically not subject to change. Clients must be advised that the licensed rights are only for a specified term and that renewal is contingent upon satisfying conditions stated in the agreement, subject to state statute protections that may or may not be helpful. It still may not be “fair,” but the franchisee at least has all available information upon which to base its decision. The bottom line is that...
Has the Traditional Automobile Franchise System Run Out of Gas?

By Roger M. Quinland
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From books to music to groceries, the internet has radically transformed the distribution of retail goods in the last decade. Companies leading the way have become paragons of retail success (such as Apple and Amazon), while those that were slow to adapt to evolving distribution platforms have withered (Borders, Blockbuster Video). Which fate awaits the local franchised car dealership? Is it time for a change in the way cars are sold?

The Auto Dealer Franchise System

In the early twentieth century, independently owned automobile dealerships were a rarity. Automakers sold vehicles through department stores, by mail order and through the efforts of traveling sales representatives. The prevailing delivery system was direct-to-consumer sales.


Direct automaker-to-consumer sales are now prohibited in almost every state by franchise laws requiring that new cars be sold only by licensed, independently owned dealerships. The specific prohibitions in these laws vary from state to state, but most are based on two underlying principles. The first principle is that allowing automakers to sell cars directly to customers will endanger the businesses of automobile franchisees, which presumably do not have the economic resources to compete with manufacturers on vehicle pricing. The second principle is that consumers need a knowledgeable, independent sales intermediary who is capable of guiding individuals through the buying process and can later be called on for support in the event of difficulties with the vehicle.

The promotion of these principles is evident in various state franchise regulations. New York State, for example, has its Franchised Motor Vehicle Dealer Act (see, NY Vehicle and Traffic Law, Title 4, Article 17-A), which prohibits any automaker from possessing ownership in a dealership offering its vehicles. Massachusetts General Laws, Part I, Title XV, Chapter 93B, has a similar ban on manufacturer owned dealerships. In Texas, the sale of new cars is strictly controlled by Occupations Code Title 14, Subtitle A, Chapter 2301, which provides that a manufacturer or distributor may not directly or indirectly own an interest in a franchised or non-franchised dealership.

There have occasionally been challenges to the franchise distribution model for automobiles, but it has, for the most part, been accepted by automakers, dealers and consumers. Recently, however, a nascent automaker’s attempts to bypass franchised dealers in favor of direct to consumer sales has resulted in legal skirmishes with regional automobile dealer associations in New York, Massachusetts and Texas and other states.

Tesla Motors

Tesla Motors, Inc. (“Tesla”) is a San Francisco Bay area based company that designs, manufactures and sells electric automobiles and associated components. In 2008, Tesla captured the imagination of the auto buying public with its introduction the Tesla Roadster, the first fully electric sports car. The Tesla Roadster was followed by the Tesla Model S, a fully electric luxury sedan. The Model S has won several accolades and auto industry awards, including the 2013 Motor Trend Car of the Year, Automobile Magazine’s 2013 Car of the Year, and Time Magazine Best 25 Inventions of the Year 2012 award. Tesla posted profits for the first time during the first quarter of 2013.

In 2008, Tesla began opening automobile retail “Galleries.” This retail model has been opposed by numerous state auto dealer associations, including those in Colorado, Massachusetts, Illinois, New York, Oregon, Texas, and North Carolina, on the basis that Tesla’s retail Galleries operate in contravention of each state’s dealership franchise laws. Tesla argues that since no automobile orders are actually fulfilled at the Galleries, franchised dealership laws do not apply.

Typically, when customers enter Tesla’s Galleries, they have an opportunity to ask questions and read materials about a particular model. Usually, only a single car is on site. If and when a customer asks about purchasing a vehicle, a Gallery employee points out a computer connected to the Tesla factory in Fremont, California. Gallery employees do not take orders, customer payments or make
delivery arrangements with customers. Those functions are all managed from Tesla’s Fremont factory.

**Legal Challenges**

The National Automobile Dealers Association (“NADA”) represents nearly 16,000 new automobile dealers with 32,500 franchises throughout the United States and internationally. See, www.nada.org/aboutnada/. NADA and its members assert that Tesla’s Gallery sales model violates the franchise laws of several states. While NADA itself has not brought an action against Tesla, it has actively supported lawsuits by its members. These lawsuits are intended to drive Tesla towards selling cars through traditional franchised dealerships. Tesla has vigorously defended these actions, arguing that it cannot survive without the ability to sell cars directly to consumers.

In spring, 2012, Tesla opened its first Massachusetts Gallery in the fashionable Natick Mall. Within weeks of its opening, a lawsuit was brought against Tesla by the Massachusetts State Automobile Dealers Association (Mass. Auto. Dealers Assoc., Inc. et al v. Tesla Motors MA Inc., No. CV2012-1691, Mass. Super. Ct., Norfolk Cty. Dec. 31, 2012). In MSADA v. Tesla, the plaintiff claimed Tesla was violating Massachusetts law by conducting sales within the commonwealth at dealerships in which the company has an ownership interest. Tesla countered that because all orders from its Natick Gallery are taken and fulfilled at its California factory, there is no actual sale taking place in Massachusetts. The MSADA argued that Tesla’s delivery method is merely a dodge of the intent of the Massachusetts law.

In January 2013, a Massachusetts Superior Court judge ruled against MSADA, finding that state law doesn’t necessarily give dealers standing to pursue legal claims over manufacturer-owned stores. “This court is unconvinced that the 2002 amendment to Chapter 93B expanded the purpose of the statute to protect the motor vehicle franchise system,” stated Judge Kenneth J. Fishman, referring to provisions of Massachusetts law regarding trades. Id. MSADA is currently considering an appeal of Judge Fishman’s decision.

A New York Supreme Court judge gave Tesla another victory in its efforts to avoid the traditional franchised auto dealership structure. In Greater N.Y. Auto. Dealers Assoc. v. Dept. of Motor Vehicles, No. S865-12, 2013 WL 3242761 (N.Y. Sup. Ct. Albany Cty. Apr. 10, 2013), Justice Raymond J. Elliott III concluded that the Greater New York Automobile Dealers Association could not assert a claim against Tesla under the New York Franchised Dealer Act. The court also ruled that the dealers could not prove injury arising from the three Tesla Galleries and two service depots currently operating in the state. Id. at *5.

The Greater New York Automobile Dealers Association is predictably unhappy with the ruling, arguing that Tesla’s factory-owned dealer model is “clearly prohibited” by the state’s franchise dealer law. The Dealer Association has not, however, indicated that it will appeal the decision or seek other recourse.

Tesla’s efforts have, however, suffered major setbacks. In April 2013, Tesla’s CEO, Elon Musk, appeared before the Texas Legislature’s House Business and Industry Committee to voice his support for two bills that would allow Tesla to sidestep the state’s franchise dealership laws and sell cars directly to Texas residents. If adopted into law, the two bills—Senate Bill 1659 and House Bill 3351—would provide Tesla with narrowly tailored exemptions from Texas franchise laws. The bills provide that American manufacturers of electric cars that have never previously had franchised dealerships could sell cars directly to Texans.

House Bill 3351 was replaced by a committee substitute that offered auto dealers another layer of protection: if Tesla sells more than 5,000 cars a year in the Texas, it will become subject to existing franchise regulations.

Both Tesla-backed bills failed to reach the floor of the Texas House or Senate for a vote before the Legislature’s regular session ended on May 27. The Legislature will not meet again in a general session until 2015.

More bad news for Tesla recently came from the governments of Virginia and North Carolina. In April 2013, Tesla’s application to the Virginia Department of Motor Vehicles to grant it a special exemption to operate a dealership in that state was declined. Tesla can, and likely will, appeal this decision. On May 9, the North Carolina Senate unanimously passed a bill that appears to be intended to preemptively hinder the automaker. If the bill is passed by the House and signed into law by Governor Pat McCrory, Tesla will be required to sell its cars exclusively through independent dealers in North Carolina.

Tesla has offered an olive branch to automobile dealers by indicating that the company may use franchised dealers after it is on more solid economic footing. Elon Musk has also stated that he would be open to a discussion of a dual retail network—a combination of Tesla-owned and independently owned dealerships—when Tesla’s sales reach one percent of new-car sales market in the United States.

**Conclusion**

The likelihood that Tesla will successfully convince federal courts to invalidate the various state auto dealer franchise laws in their entirety is remote. In the author’s opinion, Tesla’s greatest chance for success lies with convincing the courts that narrow exemptions from state regulations should be tailored for the continued on page 13
Not Your Father’s Arbitration

By Peter R. Silverman
Shumaker, Loop & Kendrick, LLP

Responding to surveys of their corporate users, major arbitration providers are training arbitrators to promote speed and economy. Here’s a list of what I think the best arbitrators’ initial assumptions should be at the preliminary conference:

• Two to four months to finish fact and expert discovery.
• Focused and limited discovery, and disputes resolved within 48 hours of notifying arbitrator.
• No motions allowed unless they’re dispositive and strong.
• Hearing finished within six months of preliminary conference.
• Hearings open to new speed/economy procedures like direct testimony through affidavit, or “hot-tubbing” experts (putting them on at the same time in a point-counterpoint procedure).
• Continuances strongly disfavored.

Expect this from best arbitrators, and plan strategy around these expectations. Depending on your goals, consider writing specifics in your clause — pressing an old-school arbitrator to adopt these standards, or having strong reasons to persuade a new-school arbitrator to deviate from them.

If you’d like a copy of my form preliminary conference explanation and order that includes these expectations and more, e-mail me at psilverman@slk-law.com.

Peter R. Silverman

Nomination Report

From Joe Fittante
Forum Chair

I am pleased to let you know that Ron Gardner, Chair of the Nominating Committee, has reported the results of the Committee’s deliberations.

The nominees are:

Governing Committee - (3-year terms, commencing August 2014)

Ron Coleman
Parker Hudson Rainer & Dobbs LLP
Atlanta, GA

Jim Goniea
Wiggin & Dana
Philadelphia, PA

Allan Hillman
Kern & Hillman LLC
Hamden, CT

Eric Karp
Wittmer Karp Warner & Ryan LLP
Boston, MA

Forum members will vote on these nominations during our annual business meeting on Friday, October 18, 2013, in Orlando, FL. I would like to thank Ron, Shellie Spandorf, Jon Solish, Jane Cohen and Himanshu Patel for their service on the Nominating Committee.

36th Annual Forum on Franchising Goes Mobile!

In keeping with our efforts to provide relevant and real time information to Forum members, we will once again be releasing our own Mobile App for IPhone, Android and Blackberry on September 16, 2013. Our mobile app will permit you to:

• Easily navigate the hotel and conference center
• View paper and PowerPoint materials for the entire conference (meaning you never have to miss a session again!)
• Create your own personalized schedule to maximize your time at the meeting
• Communicate, connect and network with colleagues and speakers at the event
• Interface with the Forum’s social networking site to join in on the meeting chatter
• Receive important real-time alerts and updates from the Forum leadership and staff

Check the Forum’s LinkedIn and Facebook pages for information on how to access the App.

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Message from the Editor-in-Chief

By Max J. Schott, II

It is hard to believe that this is my last issue as Editor-in-Chief of The Franchise Lawyer. Admittedly, twelve issues seemed like a daunting task as I began my three-year tenure in 2010, but it has been a wonderful journey. During this time, the publication (i) has returned to print in response to sentiments expressed by a number of you in the most-recent membership survey, (ii) is still offered electronically in the new ABA electronic newsletter format for those of you who would rather read it that way, and (iii) has added a new “Pointer & Pitfalls” section to provide practical information to practitioners and more opportunities for members, especially our newer members, to write. I am proud of these changes and hope that they have increased the value of TFL to Forum members.

The Franchise Lawyer is far bigger than one person, however, and the publication never would have made it to your computer, hand-held device, tablet or mailbox without the assistance of a number of folks that I want to publicly thank.

Thank you to the following talented group of Associate Editors who served with me during my tenure: Glenn Plattner of Bryan Cave in L.A., Kristy Zastrow of Dady & Gardner in Minneapolis, Beata Krakus of Greensfelder, Hemker & Gale in Chicago; Kevin Shelley of Kaufmann Gildin & Robbins in New York; and Himanshu Patel of Zarco Einhorn Salkowski & Brito in Miami. In addition to their top-notch skills as editors, this group’s enthusiasm, legal smarts and humor have made the publication better, and my job easier and much more fun.

Thanks to all of you who have contributed or are in the process of contributing articles to TFL -- some of you voluntarily and others of you with a little coaxing. While I am pleased with the pipeline we have established, the publication can always use new articles and authors. As I have stated many times before, The Franchise Lawyer is only as good as the articles submitted to it from Forum members like you.

A BIG thank you to all of the ABA staff who have worked with and guided me over the past three years, including Kevin Bailey, Kelly Book, Karrie Dowling, Elmarie Jara, Yolanda Mohammed, Kim Nelson, Nick Panos, Claire Parins, Jill Peña, Kelly Rodenberg and Andrea Siegert. Despite some bumps in the road created by the ABA’s transition to a new website and the implementation of various forms of electronic formatting, the ABA staff persevered and got the job done, often times under tight deadlines. I am truly grateful for their support.

I especially want to call out the exceptional work of Art Director Andrea Siegert. In addition to creating the layout for each issue, she was the creative force behind the fresh, crisp look of the new print version of TFL that also pays homage to the old design.

I also would be remiss if I did not mention the valuable proofreading, cite checking and other support I received from a number of individuals within my firm, including Jayme D’Heilly, Scott Raver, Lois Siljanger and Walli White. Thank you!

Last, but not least, thank you to Corby Anderson who has agreed to become my successor as Editor-in-Chief of TFL. Corby is a terrific editor and attorney, and I have every confidence that she will do an excellent job in her new role.

My increased involvement with the ABA Forum during my tenure has only strengthened my opinion that it is a truly unique organization that provides unparalleled value to its members. I have appreciated the opportunity to serve.

In closing, I leave you with a quote from Shel Silverstein’s Roger Was A Razor Fish, And Other Poems:

If there is a book [or in this case an article] you want to read but isn’t written yet, write it.¹

¹This seemed more profound than, “Be excellent to each other. And party on, dudes.” — Bill & Ted’s Excellent Adventure, which was definitely a close second.
Recognize Your Outstanding Colleagues in Franchising!

If you know someone who qualifies for any of the below awards, please let us know.

**Lewis G. Rudnick Award**
The Rudnick Award will honor members of the Forum who, over the course of distinguished careers as franchise lawyers, have made substantial contributions to the development of the Forum and to franchise law as a discipline -- by publishing scholarly articles; writing or editing texts; speaking at franchise law meetings; serving the Forum as an officer, committee chair or member, or journal editor; and/or recognized accomplishments as a practicing franchise lawyer - while comporting themselves in accordance with Lew Rudnick’s high standards of professionalism, decency and collegiality.

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

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

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

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

Please send your nominations for all awards by September 1st to the Forum Chair, Joe Fittante at jfittante@larkinhoffman.com. Joe will choose the recipients, subject to the approval of the Forum Governing Committee, and the awards will be presented at the 36th Annual Forum on Franchising this October in Orlando, FL.

If you know someone who qualifies for any of the below awards, please let us know.
36th Annual Forum on Franchising – Franchising in Full Animation

By Diane Green-Kelly and Eric H. Karp
Program Co-Chairs

October 16–18, 2013 At the Rosen Shingle Creek Resort in Orlando, Florida

Every year in October, the Forum on Franchising offers a four-day legal conference featuring unparalleled educational programs and collegial social events, where attendees network with familiar and new franchise bar colleagues, clients and friends. Come to the Forum in Orlando, which promises to be one of the finest and most memorable events in Forum history. Highlights that make this an event you will not want to miss include:

**A Forum Tradition.** On Wednesday, October 16, highly experienced franchise attorneys will present Fundamentals of Franchising, the finest course available on the basics of franchise law. This five-hour intensive program covers structuring the franchise relationship, registration and disclosure requirements, trademark and other intellectual property issues, antitrust, franchise relationship laws, and a primer on representing franchisees.

**A Forum Primer.** Also on Wednesday, October 16, two additional five-hour intensive programs will be offered: An in-depth program on the theory and practice of mediating a franchise dispute, featuring a mock mediation, and Fundamentals of International Franchising, a program directed at U.S. attorneys featuring experienced practitioners from both sides of the pond. These intensive programs are a must for both new and experienced franchise counsel.

**A Forum Essential.** On Thursday and Friday, October 17 and 18, twenty-four engaging, unparalleled workshops cover a variety of legal developments and business challenges facing the franchise industry. Whatever your practice — in-house or outside counsel, transactional lawyer or litigator, franchisee or franchisor lawyer — you will have many thought-provoking and worthwhile choices.

**A Forum Signature Focus.** Its outstanding plenary sessions, including the popular Annual Developments, a survey of the key cases and decisions in franchise law over the last year, as well as a roundtable of Past Chairs of the Forum, discussing franchising in the Forum’s 36th year and sharing their views on where we have been and where we are going.

**A Forum Don’t Miss It Location.** Join us in the World of Harry Potter at Universal Studios Orlando on Thursday night and bring your entire family. Enter the magical world of the boy wizard and connect with familiar and new Forum colleagues, clients and friends. You will have complete and exclusive access to Hogsmeade Village, including three roller coaster rides. A delicious buffet will be served following pre-dinner entertainment. You will then have the rest of the evening to enjoy the numerous shops and displays recreated from the Harry Potter world.

**A Forum Dinner and Beach Party.** Come join us at Discovery Cove, a part of Sea World. Attendees can network in a lush tropical setting while enjoying cocktails and dinner followed by a beach party in what is sure to be a relaxing and enjoyable evening.

**A Forum Legacy.** On Saturday morning, give back to the community that serves as our host as we head out to A Gift for Teaching. See details on next page.

We look forward to greeting you on Wednesday at one of the intensive programs or the Welcome Reception, interacting and learning with you at the educational workshops and networking with you at Universal Studios and Discovery Cove.

Don’t miss this opportunity to join your franchise bar colleagues, clients and friends at America’s premier franchise law event.

Interested in registering for this event? Register now at http://www.registration123.com/aba/13FRANCHISING/ or call Technical Registration Experts at 877-309-1565.

Questions???
If you have questions or require additional conference information, please call 312-988-6319. Fax: 312-988-5677; email: kathryn.henning@americanbar.org.
Annual Forum Community Service Event: A Gift for Teaching

Please join us on Saturday, October 19, 2013, from 8:30 am - 12:30 pm as we volunteer at A Gift for Teaching in Orlando, Florida. For this year’s community service event, the Corporate Counsel Steering Committee, the Women’s Caucus, and the Diversity Caucus invite you back to school! A Gift for Teaching is an organization that began in 1998 to improve public education by providing resources and surplus materials free to teachers for their students in need. Since its inception, A Gift for Teaching has distributed over $70,000,000 worth of supplies to Florida’s highest-need schools and classrooms. The tri-county-wide operation includes Free Stores, allowing teachers to shop for their students without having to spend their own money. From 9 a.m. to noon on Saturday, volunteers will sort school supplies and perform other projects at the Orlando warehouse. The Free Store will be open during that time, so volunteers will be able to see the teachers who will directly benefit from their work. Transportation from the hotel will be provided.

For attendees who cannot make the event but would like to contribute, we will be collecting donations leading up to Saturday morning.

Interested in registering for this event? http://www.registration123.com/aba/13FRANCHISING/

Questions???
Yolanda Muhammad, Forums Director, Phone: 312-988-5794, Email: Yolanda.Muhammad@americanbar.org

Become a California Board Certified Franchise & Distribution Specialist!

The State Bar of California’s Board of Legal Specialization invites you to take the 2013 legal specialization exam. The examination is open to active members of the State Bar of California who have practiced franchise and distribution law since at least January 2012. It is the first step in becoming a certified specialist. Take advantage of this opportunity now! If you miss the 2013 exam, the next exam is not until 2015.

Exam Date: Tuesday, October 22, 2013
Application Deadline: September 10, 2013. Late applications will be accepted until October 15, 2013 at an additional fee only if space is available.
Exam venues: Pasadena and San Francisco

For more information about the exam, or full details of the requirements for becoming a Certified Franchise and Distribution Law Specialist, visit: www.californiaspecialist.org, email legalspec@calbar.ca.gov or call 415-538-2120.

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franchisees must clearly understand that renewal rights are not absolute, and, most importantly, what is being renewed is not the form of agreement they originally signed, but the right to continue operating the franchised business. This right may in fact look (and cost) substantially different than what it did when the initial franchise agreement was signed many years before.

What Do You Mean I Can’t Renew?
Continued from page 8
Fundamentals of International Franchising, 2nd Edition

Edited by Will K. Woods

Franchising continues to be a global phenomenon as U.S. companies continue to expand their brands outside of the United States. Providing you with the most updated information in this area of the law and to help you plan and prepare for global expansion, this resource guides you through the critical aspects of effectively and efficiently expanding a franchise beyond the United States.

Helping you minimize the risks and maximize the rewards as companies participate in the complex and often difficult process of global expansion, this book takes you through the process in an orderly and detailed manner. The authors provide valuable guidance from the initial choice and effective use of local counsel and the business decision to “go international,” through legal considerations, including specific franchise, intellectual property, and other local laws with potential impact on franchise expansion, as well as U.S. tax implications and dispute resolution issues.

Fundamentals of International Franchising, 2nd Edition provides you with guidance on:

- What the pros and cons are when considering international expansion
- The special clauses and contractual language you should use
- The tax issues that must be addressed by corporations engaged in cross-border franchising activities in order to receive favorable tax treatment

Fundamentals of International Franchising Intensive Program

Don’t miss the Fundamentals of International Franchising intensive program at the 36th Annual Forum on Franchising in Orlando on Wednesday, October 16. This five-hour program is a must for practitioners that are new to international franchising or are developing (or want to develop) an international franchise practice. A panel of experienced international franchise lawyers will walk through the key issues about which everyone practicing in this area must be aware.

Participants will receive a complimentary copy of the updated edition of the Fundamentals of International Franchising and will be invited to attend a complimentary international dinner on Tuesday, October 15 for an evening of networking with other international franchise practitioners. Register online for the Annual Forum and this intensive at http://www.registration123.com/aba/13FRANCHISING/.

To order, call the ABA Service Center at (800) 285-2221 or visit our website at www.americanbar.org/groups/franchising/publications.html

General Public Price $150.00
Forum on Franchising Member Price $125.00