Recognizing that our members are the life-blood of this organization, the Governing Committee spends a significant amount of time discussing different ways to provide ongoing value to our existing members and to attract new members to the Forum. To that end, over the last year the Governing Committee has developed a five-year strategic plan to invest Forum funds with three specific goals in mind. First, to increase the value of Forum membership to existing members. Second, to increase participation in the Forum. Third, to maintain membership at or above our historical levels.

Based upon this strategic plan, we have identified specific initiatives the Forum will undertake over the next year in an effort to accomplish the goals discussed above. These initiatives, which are discussed below, touch on various Forum areas including publications, membership, marketing, the Annual Meeting, programming and technology.

In an attempt to provide additional value to our membership, we are converting many of the Forum’s publications to e-books so that members can simply download them using their technology of choice. We also are moving away from the CD. Going forward, each Annual Meeting attendee will be provided with a Thumb Drive containing Annual Meeting materials that can be easily accessed by the attendee. In addition, we have approved a pilot program where one workshop at the Annual Meeting will be videotaped and then replayed after the Annual Meeting for those members who may have missed it. Finally, in an effort to improve communications with our members, we will be performing quarterly mailings to our membership advising them on current programming, new publications and the current state of the organization.

In hopes of growing our membership and consistent with our charter to provide outreach on franchise legal issues, we have engaged a third party marketing firm to provide us with advice on the most effective ways to grow the Forum brand and attract individuals who may be practicing in the franchise area but are not currently Forum members. In furtherance of our goal to grow Forum membership and in recognition of the fact that growing membership and attendance at our Annual Meeting go hand-in-hand, we will once again offer the first and second time attendee discount that we have offered over the last couple of

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Removing the Shroud of Mystery from the Patient Protection and Affordable Care Act’s Employer Mandate

By Chris DeMeo and Kelly Ganzberger
Munsch Hardt Kopf & Harr, P.C.

When President Obama signed the Patient Protection and Affordable Care Act (“PPACA”) into law on March 23, 2010, franchisors and franchisees sounded the alarm about the potential costs of having to provide health care coverage to their employees. Their concerns were supported by a 2011 study by the Hudson Institute, “The Effects of the Patient Protection and Affordable Care Act on the Franchise Industry” (available at www.franchise.org/healthcare), which found that the PPACA would result in approximately $6.4 billion dollars in increased costs to employers (not including the costs of regulatory compliance), and that the jobs of more than 3.2 million full-time employees were at risk in the franchise industry.

Following the Supreme Court’s decision in National Federation of Independent Business v. Sebelius, 567 U.S. ____ , 132 S.Ct. 2566 (2012) and President Barack Obama’s reelection in November, it is likely that the PPACA will remain the law of the land for the foreseeable future. Franchisors and franchisees alike must take immediate steps to educate themselves and prepare to comply with the major regulatory requirements of the PPACA that are set to become effective in 2014. This article provides a brief and limited overview of one of the more controversial provisions of the law—the employer mandate—and its interaction with other provisions of the PPACA, including the individual mandate and the development of health insurance exchanges. The application of the PPACA is important to the franchise community because franchisors and franchisees may take preventative measures in 2013 in order to avoid a higher tax liability in 2014.

What is the Employer Mandate?
The “employer mandate” refers to the provision in the PPACA whereby certain employers may face a tax penalty if they do not offer affordable health insurance or offer health insurance that does not provide minimum value to their full-time employees or full-time equivalents, and their dependents. The PPACA doesn’t just levy penalties for non-compliance; indeed some employers will be entitled to a tax credit for offering health insurance to their employees. Further, the PPACA creates state health insurance exchanges whereby reduced-cost, subsidized health insurance can be purchased by certain individuals and employers.

Franchisors and franchisees who are subject to the employer mandate should note that the PPACA requires substantial changes to health insurance plans that are offered by employers and insurance companies, which will likely increase the cost of coverage. The most publicized requirement is that, for plan years beginning on or after January 1, 2014, all individuals must be covered regardless of pre-existing conditions. Other provisions that are less well-known, but may prove just as costly, are that plans may not have an annual or lifetime cap on “essential health benefits” paid and that some health services, such as annual well exams, may not require a co-payment. This is not an exhaustive list of the changes to plans, and franchisors and franchisees should consult an insurance professional when preparing to offer a plan to their employees.

The applicability of the employer mandate is determined by the number of full-time employees and full-time equivalents of the employer:

0–25 Full-Time Employees: Not subject to the employer mandate. Instead, these employers are offered tax incentives if they offer and subsidize at least fifty percent of the cost of their employees’ health insurance coverage for employees making less than $50,000 a year. These employers have the option to purchase subsidized health insurance for their employees through a state health insurance exchange.

25–49 Full-Time Employees: Not subject to the employer mandate and no tax incentives offered. However, these employers may purchase subsidized health insurance for their employees through a state health insurance exchange.

50+ Full-Time Employees: Subject to employer mandate, and significant tax penalties apply for failure to offer health insurance to employees. Further, even if the employer offers health insurance to its employees, it may still face tax penalties.
Defining Full-Time Employees and Full-Time Equivalents

The first step in determining whether an employer is subject to the mandate is calculating the number of full-time employees. Generally, an employee is considered to be a full-time employee for a month if he/she works an average of 30 or more hours per week in that month. The employer would calculate actual hours of service from records of hours worked and hours for which payment is made or due.

For purposes of determining whether the employer mandate applies, full-time equivalent employees are also counted. In order to determine how many full-time equivalent employees an employer has per month, the employer uses a mathematical formula: (1) calculating the aggregate number of hours worked by all part-time employees (with a cap of 120 hours per employee per month), and (2) dividing the total number of hours in step one by 120. The sum will equal the number of full-time equivalent employees for that month which is then added to the number of full-time employees to determine applicability of the mandate. For example, if the employer has 10 part-time employees who work a total of 240 hours for a month, the number of full-time equivalents for that month is 2 (240 divided by 120). If an employer’s average number of full-time and full-time equivalent employees is 50 or more for the calendar year 2013, the employer mandate will apply in 2014. Special rules apply for seasonal employees.

Franchisors and multi-unit franchisees should consult with an advisor regarding whether they may be considered a “control group” whereby commonly owned or controlled entities are treated as a single employer. For purposes of the applicability of the employer mandate, PPACA incorporates existing Internal Revenue Code provisions for determining when multiple companies (including parent, brother, and sister companies) are considered one employer for purposes of providing employee benefits. As such, separately incorporated franchised units may be considered a single employer if certain common ownership requirements are met.

Safe Harbor Provisions

Once an employer determines that it has more than 50 full-time employees or their equivalents and is subject to the employer mandate, it will need to determine if any safe harbor provisions apply to any of its existing or newly hired employees for purposes of determining and calculating if the coverage provided is not affordable or does not provide minimum value. No tax incentives are offered. The employer may purchase subsidized health insurance through a state health insurance exchange only in limited instances.

Penalties for Non-Compliance

Franchisors and franchisees with at least 50 full-time employees or their equivalents will have to make the difficult decision of whether to pay for insurance premiums, or pay the penalty for failure to comply with the employer mandate. As noted above, there are two possible tax penalties; one for failure to provide insurance and another for providing insurance that is too expensive or does not provide minimum value.

Failure to Provide Insurance (IRC 4980H(a)):

An employer will be required to pay an annual tax penalty of $2,000 times the total number of full-time employees if:

1. The employer does not offer employees and their dependents minimal essential coverage; and
2. The employer has at least one full-time employee who is both:
   a. enrolled in a health plan offered by an approved health insurance exchange, and
   b. is eligible for an applicable premium tax credit or a cost-sharing reduction.

An employee qualifies for the tax credit or
reduction if the employee’s household income is between 100-400% of the U.S. poverty line ($23,050-$92,200 for a family of four in 2012). For purposes of calculating the tax, the first 30 full-time employees and equivalents are not counted. For example, if an employer with 130 full-time employees and equivalents fails to offer coverage and has one full-time employee who meets the criteria in number 2 above, the employer will pay an annual tax penalty of $200,000 ($2,000 x 100 full-time employees and equivalents over the 30 exempted).

Insurance Provided is Too Expensive or Does Not Provide Minimum Value (IRC 4980H(b)): An employer will be required to pay an annual tax penalty equal to the lesser of (a) $3,000 times the number of subsidized workers, or (b) $2,000 times the number of full-time employees, if:

1. The employer offers employees and their dependents minimal essential coverage; and
2. The minimal essential coverage is either too expensive because the employees’ portion of the cost (premium, deductibles, co-insurance, copay) is 9.5% or more of the employee’s household income or it does not provide minimum value because the plan’s share of the total allowed costs of benefits provided under the plan is less than 60% of those costs; and
3. The employer has at least one full-time employee who is both enrolled in a health plan offered by an approved health insurance exchange and is eligible for an applicable premium tax credit or a cost-sharing reduction.

How does an employer determine if an employee’s portion of the cost of insurance is “9.5% or more of the employee’s household income” if employers are not allowed to request that information from employees? Employers may use a safe harbor provision for the year 2014 by measuring affordability of the plan against the employee’s W-2 wages. If the employee’s share of the cost of insurance is less than 9.5% of the employee’s reported wages from 2013, then there will be no penalty to the employer.

The IRS and HHS indicate that a calculator will be available on their respective websites for determining minimum value of a plan.

Penalties under this provision are capped so as not to exceed the employer’s potential liability for failure to provide insurance pursuant to IRC 4980H(a).

Play vs. Pay: Risk Assessment
An employer with at least 50 full-time employees and equivalents will want to consider several additional factors before determining whether to “play or pay” (i.e. provide affordable coverage or pay the penalty). The following scenarios identify possible outcomes for employers that decide not to offer affordable minimum essential coverage to its full-time employees. Employers can measure these scenarios against their historical experience to make an educated risk/benefit analysis of how to move forward. Each employer’s situation is different, and the ultimate decision should be made with an understanding of the bottom line cost and ongoing employee relations.

First, an employee may choose not to enroll in a plan offered through the health insurance exchange. The United States Supreme Court held in National Federation of Independent Business v. Sebelius, 567 U.S. __ , 132 S.Ct. 2566 (2012), that the government can only enforce the individual mandate as a tax. It is possible that the tax on individuals for failure to secure insurance will be less than insurance premiums available through the health insurance exchange. In this regard, the Supreme Court noted that an estimated 4 million people are expected to pay the tax. Alternatively, employees may receive insurance through a third party’s employer, such as their spouse or parent. In those cases the employer penalty would not be triggered. Employers whose workforce historically has not taken full advantage of health benefits offered may consider this possible scenario in estimating their potential liability for the penalty.

Also, an employee may be able to afford insurance in the health insurance exchange without qualifying for a tax credit or cost sharing reduction. Individuals whose household income is over 400% of the U.S. poverty line ($92,201 for a family of four in 2012) do not qualify for the tax credit or reduction, and thus would not trigger a penalty for
Alternative to the Traditional Franchise Model: Yellow Brick Road or Perilous Path?

By Kara K. Martin and C. Christian Thompson
Thompson Ostler & Olsen

A profitable and mature franchisor or a less developed franchisor with sufficient capital and profitable locations should explore the JV/Series LLC model (“Ownership Model”) to grow its system. This model provides the potential for greater control and a higher return on investment.

This article is not an attempt to explain how to structure a business system so that it falls outside the definition of a franchise under the FTC Franchise Rule or state franchise laws. (For more information on how to structure your business to not qualify as a franchise read, You Don’t Want to be a Franchise? Structuring Business Systems not to Qualify as a Franchise, Hurwitz, Ann and Oppenheim, David W., 34th Annual Forum on Franchising (Oct. 2011)).

Additionally, it is very difficult to avoid the three elements of a franchise if the minority owner contributes any money within the first six months (See Hurwitz and Oppenheim, 36-40). Thus, this article assumes that the franchisor is not seeking to avoid a franchise, but instead seeks to structure the franchise through an Ownership Model.

JV/Series LLC Model

While there may be variations on how this model is set up, from our research, the most typical scenario is that a franchisor, or an affiliate and/or wholly owned subsidiary of the franchisor (“franchisor”), is the majority member in separate LLC’s with individual operating owners. Each LLC, as a separate and distinct franchisee entity, enters into a franchise agreement with the franchisor. Both the franchisor and the operating owner are responsible to contribute their predetermined share of the start-up costs (based on percentage of ownership). If an operating owner does not have sufficient capital, the franchisor may consider providing financing secured by the operating owner’s percentage interest in the LLC. The franchisee entity then enters into an employment agreement with the operating owner setting forth specific duties of the operating owner/on-site manager. The operating owner receives a salary for managing the location and running the franchise, and both s/he and the franchisor receive a share of distributions based on ownership in the LLC. The operating agreement provides buy-back rights to the franchisor if the operating owner is terminated for failure to comply with the employment agreement.

Advantages

System Growth

One appealing advantage is that this model expands the pool of potential franchisees available to the franchisor. Funding is one of the biggest obstacles to purchasing a franchise, and this model significantly lowers an operating owner’s initial investment because the franchisor is fronting its share of the costs. In many instances, it is easier to find someone with operations experience and little capital than someone with both experience and sufficient capital to purchase a franchise outright. Additionally, banks are more likely to loan money to a franchisee entity that also includes the franchisor as a member of the LLC.

Greater Return of Profits

Owning a majority ownership in the franchisee entity could return greater revenue to the franchisor than a straight royalty. In general, a 6% revenue royalty is equal to 25%-30% of a franchisee’s net profits. Therefore, a majority ownership in a profitable franchisee entity could generate income equal to a 12%-15% royalty. The clear disadvantage to this model is that the franchisor only receives income if the franchisee is profitable, whereas, under a straight royalty, the franchisor generally receives royalty payments irrespective of whether the franchisee turns a profit. Thus, this model should only be considered for systems where the unit franchisees are very profitable.

More Control

A franchisor with a majority interest in the franchisee entity can better protect its brand. Through the employment agreement, the franchisor can place additional expectations and duties on the operating owner that it generally would not be able to impose on a franchisee. For example, poor

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operating owners can be removed for such things as failing to meet sales and profit quotas, inventory controls, employee mismanagement and spending limits. If terminated, the franchisor can remove the operating owner and repurchase his/her interest pursuant to the operating agreement without needing to terminate the franchise agreement. Furthermore, a franchisor can more easily manage the operations until a new operating owner (who would likely need to be disclosed) is found. Contracts with the vendors, property leases, utilities, insurance, employee payroll, etc., remain the same.

"The Ownership Model is not for every franchisor: however, if the franchise system has sufficient capital and its locations are profitable, it may be the model to take its system to the next level."

Less Liability to the Franchisor
There is an argument that the franchisor is better shielded from liability when it owns a controlling interest in the franchisee entity. As a member of a multiple-member LLC, the franchisor is provided protection from lawsuits brought against the franchisee entity. This likely provides more protection than if the LLC were a wholly owned subsidiary. The case law is extensive in this area demonstrating that courts are reluctant to find liability with the parent of a subsidiary company. See, e.g., MA Equip. Leasing I, LLC v. Tilton, 2012 Ohio 4668 (Ohio Ct. App., Franklin County 2012) (discussing the need for courts to respect the separateness of entities). Because of the reluctance of extending liability to a parent entity, piercing the corporate veil may prove more difficult to a defendant than a vicarious liability theory.

In addition, vicarious liability arguments may be weakened if the franchisor provides few controls over the franchisee entity through the operations manual. The franchisor would instead control the franchise operations through the employment agreement. Arguably, under this scenario, the franchisee entity, and not the franchisor, would be controlling the operations owner. It may be a matter of semantics, but adding an additional layer of protection may give the franchisor some needed protection to avoid liability. While this opens up some system control issues, in a carefully drafted employment agreement, a rogue or misguided manager (who is also a member of the franchisee LLC) could be more easily removed when that person deviates from the system controls that are inserted into an employment agreement.

Disadvantages
There are many advantages and risks to the Ownership Model. If you have a client looking for more income from the franchise or more control of the franchise operations, then an Ownership Model might be the answer. However, in abandoning the traditional model, the franchisor assumes more financial risk as well as potential increased liability for employee and labor claims, vicarious liability and other third party claims directly against the franchisor. Traditionally, the franchise concept shifts the financial burdens and the liability to the franchisee. But in an Ownership Model, the franchisor may be assuming these risks. From the Forum on Franchising’s annual legal update, it is clear that franchisee attorneys and courts are increasingly finding ways to impose liability on the franchisor for the acts or omissions of the franchisee. This trend would seem to accelerate in situations where the franchisor is also acting as a franchisee through the Ownership Model.

Financial Burden
The Ownership Model ties up and exposes much more of the franchisor’s capital than with traditional franchising. One of the perks of franchising is using other people’s capital to grow the business. If a franchisor is a majority owner of the franchisee entity, it will assume a majority of the financial responsibility for operating costs and likely be a guarantor on property leases and bank loans. And while it is appealing to have a wider pool of candidates, there has to be sufficient capital to actually benefit from that expanded pool. If a franchisee fails under the Ownership Model, the franchisor does not simply lose a source of royalty revenues; it loses all the capital put into that franchisee and incurs potential liability for the debts of the franchisee. And, if the franchisor had overextended itself in entering into an Ownership Model franchise relationship, a failed franchisee could result in a failure of the entire system.
Vicarious Liability

Vicarious liability may increase exponentially when the franchisor owns part of the franchisee. The touchstone in making a determination of whether to impose vicarious liability on the franchisor is the level of control exerted over the franchisee’s operations. In addition to providing standard controls through its operating systems and manuals, inherent in the ownership relationship is greater participation in the direct operational controls of the business. We have seen vicarious liability tested within the traditional structure in cases examining franchisor liability for personal injury, sexual harassment, wage claims and numerous other issues. Each time, the level of control exercised by the franchisor is scrutinized. Courts have generally upheld the idea that a franchisor is not liable for the acts or omissions of the franchisee if the franchisor only exercises limited control over the brand, goodwill, trademarks and quality, or did not, otherwise, have control over the negligent act. See, e.g., Cano v. DPNY, Inc., 2012 U.S. Dist. LEXIS 161284 (S.D.N.Y. Nov. 8, 2012) (discussing franchisor liability for overtime wages); Kettering v. Burger King Corp., 152 P.3d 527 (Idaho 2012) (no liability of franchisor found in slip and fall because of franchisee control of premises). However, in an Ownership Model, the franchisor would be imposing control through its operating systems and manuals, as well as in the direct operational controls of the franchisee’s business. This additional level of control would likely tip a court in favor of imposing liability to the franchisor.

Furthermore, liability can be passed to the franchisor because the separation between the franchisor and the franchisee under the Ownership Model becomes blurred. When the franchisor owns part of the franchisee entity, the franchisor is more readily open to challenges to its separate liability. It is true that if the franchisor’s ownership in the franchisee is through a wholly owned subsidiary, the direct liability is diminished. Nevertheless, even in these instances, franchisors must be very careful to implement necessary measures distancing the subsidiary from the parent so as to avoid indirect liability. Where the subsidiary is not acting independently or there is an appearance of apparent agency, there is greater credibility to the alter ego argument that will inevitably surface in a lawsuit.

Traditional franchise agreements often contain requirements that the franchisee posts signs inside the business, on business cards, in advertising and media, and in third party contracts, stating that the franchise is independently owned and operated. But once the franchisor is an owner of that business, it becomes more difficult to argue that the franchise is truly independently owned and operated. Similarly, the franchise agreement provision disavowing the principal-agent relationship is difficult to argue, as is an indemnification provision.

Ultimately, this issue may come down to language in the franchisee entity’s operating agreement, by-laws and even the operation’s manual, which will require a high level of precision to ensure liability remains with the purported franchisee and not with the franchisor.

Employment Issues

Under the Ownership Model, the franchisor likely opens itself to employee and labor claims. Several blog posts and articles refer to the franchisee in a joint venture relationship as a “glorified employee.” In a sense, this is correct. In a typical Ownership Model arrangement, the franchisee enters into an agreement with the franchisor, who owns a portion of the franchisee. As part of this relationship, the incoming owner operator (traditional franchisee) is paid a salary, often set by the franchisor, to run the operations of the franchise location. The Ownership Model makes it more difficult to argue that under this scenario, the franchisor is not a joint employer of the employee.

Additionally, if the employment of the franchisee/manager can be called into question, the employment of all the support staff of the franchisee could arguably be the employees of the franchisor, opening it up to liability for violation of state and federal employment and labor laws.

Unfamiliar Territory

The legal roadmap is much less clear with the Ownership Model than the traditional franchise model. In the traditional franchise structure, many of the risks encountered with alternative forms of franchising have been tested in court. After years of court rulings dealing with the agency relationship between a typical franchisor and franchisee, we can anticipate where and when vicarious liability will come into play. We also have substantial case law to help navigate employment and labor law issues (albeit this is becoming less clear each year), and the controls and ownership of the related intellectual property. All of the above, and other issues, become unknowns with alternative franchising models and, therefore, increase the franchisor’s risk and exposure to liability.

Conclusion

The Ownership Model is not for every franchisor; however, if the franchise system has sufficient capital and its locations are profitable, it may be the model to take its system to the next level. Nevertheless, if franchisors are worried about courts disregarding the franchisee entity to find liability with the franchisor in a traditional model, there is a much greater risk of this occurring in an Ownership Model. In pursuing an alternative form of franchising, the franchisor may not realize that it is taking on additional risks and liabilities.
International Expansion: Is Master Franchising the Best Approach?

By Wayne A. Steinberg and Callum Campbell
Hoffer Adler LLP

There are a lot of misconceptions amongst franchisors about how to expand internationally and the role of master franchising in that expansion. Franchisors may not be fully aware what a master franchise really is and does, and indeed whether it is the best choice for their expansion. Franchisors often do not know how and when to master franchise or whether other options should be considered for international expansion of their franchise systems.

Before expanding into other countries franchisors first need to consider a variety of business factors in deciding when and where to franchise, though that discussion is beyond the scope of this article. But once a target country has been selected and a local candidate to assist with the foreign expansion has been identified, franchisors need to determine what expansion method will work best for them and for their prospective foreign franchisees.

Characteristics of a Master Franchise Arrangement
This article focuses specifically on two extremes among the different international expansion alternatives: master franchising and area representatives. For greater clarity, in a master franchise model the franchisor enters into an initial franchise agreement with a franchisee in the target destination, and the franchisee is responsible for all further expansion in that area or country. In addition to the right to itself open one, or more, units, the franchisee, which is commonly known as the master franchisee, is also granted the right to sub-franchise. Usually the parties will agree on a mandatory development schedule requiring that a certain minimum number of unit franchises be opened each year. The unit sub-franchisees that it recruits each enter into sub-franchise agreements with the master franchisee and the master franchisee becomes the sub-franchisor, standing in the shoes of the franchisor in the foreign territory.

Characteristics of an Area Representative Arrangement
By comparison, if using an area representative instead of a master franchise model, the franchisor enters into an agreement with an area representative to recruit franchisees within an area or country. Area representative agreements may vary significantly in scope, but the focus of the agreement is the area rep’s obligation to recruit franchisees. The area representative may or may not sign a unit franchise agreement with the franchisor for its own unit franchise, and its obligations to support other franchisees in the territory also varies. However, the key to this model is that the franchisor itself enters into and services all of the unit franchise agreements with the franchisees recruited by the area representative. Unlike the master franchise model, there is no sub-franchising involved. There is only one franchise agreement signed between the franchisor and franchisee. This requires a hands-on approach by the franchisor, but permits the franchisor tighter control over its international expansion efforts since the franchisor has entered into all of the unit agreements itself and there is no master franchisee acting as a middle man.

Often, and without giving this much thought, franchisors will seize on “master franchising” as the preferred model for their foreign expansion. But, the reputation and “aura” of that model to the layperson may distort the reality of just what to expect. Franchisors often have exaggerated expectations of master franchising both with respect to the size of the income stream and the amount of work involved on their behalf. They may well be so hung-up on the “master franchise” terminology that they still wish to call the franchisee a master franchisee even though the “master” may in reality prove to be something quite different. Master franchising is not always what it seems.

Advantages and Disadvantages of the Two Models
Master franchising is not always the best alternative, and the results may be surprisingly disappointing to a franchisor that might have had better success if it had selected a different model. In the author’s view, more master franchises likely fail than succeed and this is often because the wrong expansion method may have been selected from the outset.
What are some of the innate advantages to master franchising that makes it so attractive to most franchisors? The franchisor can expand quickly if the right master franchisee is selected. The capital contributed for the expansion will also mostly come from the master franchisee, which also facilitates relatively rapid expansion without the need for a significant infusion of cash from the franchisor. And, of course, the franchisor can rely on the master’s own cultural, linguistic and other experiences in the area or country. These may well align more closely with the new unit franchisees than if the units were sold to them by an offshore franchisor from a very different culture and legal system.

But there also can be real pitfalls to using this model for a franchise system’s foreign expansion. All too often the goals and priorities of the parties are not well aligned with one another, and that can be a recipe for trouble. For example, the franchisor likely seeks rapid expansion of its network but at the same time it wants the help of the local party with nurturing the franchisees already placed in the area or country. A master franchisee with the pressure of a development schedule over it may be focused just on meeting its development requirements and may lose sight of supporting existing franchisees, to the detriment of the entire system.

Another issue is that the profitability of the model may become a real question when using a master franchise model. The franchise fee and royalty pie that would have belonged entirely to the franchisor now must be shared with the master franchisee, meaning lower returns ultimately for the franchisor. The master also must be sufficiently well compensated to make the opportunity a worthwhile investment for it. Since it only gets a shared piece of the pie, if the return on its investment is insufficient from its sale of units and from its share of ongoing royalty revenue, it may not have the financial wherewithal to succeed.

A third significant issue is a loss of control for the franchisor. Once the master franchise agreement is executed, the franchisor typically steps out of the picture with respect to the day-to-day management of the system, as it is the master franchisee that will be the “franchisor” in the subsequent unit franchise agreements that are signed in the area or country. The franchisor has no direct contract with those franchisees and, therefore, it is the master franchisee that must enforce system standards, trademark compliance and payment of all monies owing. The master franchisee will localize the training, conduct the period inspections of franchisee locations, conduct local meetings and conventions, translate manuals, advertising materials and other items used both internally in the franchise system and externally—all things the franchisor does in its home market and that allows it to control that the franchise system is being implemented according to its standards.

The franchisor is often forced to look on in frustration if the master is not as diligent as it should be, or worse still, if the master does not keep the franchisor fully informed (whether due to its negligence or intentionally).

And if the master falters significantly or if steps must be taken to terminate the master franchise, what happens to all of the unit franchise agreements signed directly with the master? Most often, the franchisor is not a party to the sub-franchise agreements, leaving it with limited options. The unit agreements do not automatically get transferred back to the franchisor unless the master franchise agreement provides for this. And even if the franchisor manages to recover the unit franchisees for itself on any termination of the master, the franchisor may in some countries lose the ability to “cherry pick” (keeping just those unit franchisees that it believes would be advantageous to it and to the system as a whole).

An often overlooked alternative to master franchising is the “area representative” model. In some cases it may work just as well and maybe a whole lot better than a typical master franchise. First, if using an area representative model, the franchisor can be less concerned about alignment of the master franchisee’s vision of how to expand with its own. The area representative will be focused on its development schedule since its main role is just recruitment. The area rep can be given a greatly reduced role in how the franchisor intends to operate its system in-territory. Second, in an area rep model the franchise fees and royalties are paid to the franchisor and it keeps a greater percentage of them, as there is no master interposed to “share in the pie.” Of course, how material an advantage that is will depend on the extent of payments that the franchisor must pay to the area rep. There may be a fixed fee payable (akin to a broker fee) or there may be a percentage payable. But since the area rep’s duties are significantly less than those of a master who has oversight and contractual obligations to its sub-franchisees, it stands to reason that any percentage payable should be substantially less than the fees payable to a master franchisee. And maybe the most important difference is that there is really no loss of control at all for the franchisor over the unit franchisees and over how the franchisor’s system will be implemented in the territory, since the unit agreements are all entered into directly with the franchisor. In the area rep model the franchisor alone makes all operational decisions about its system.

Furthermore, many of the same advantages that can be achieved from a master franchisee could also be obtained from an area rep. It is in the best interest
Covenants Against Competition in Franchise Agreements
Third Edition

Michael R. Gray and Natalma M. (“Tami”) McKnew, Editors

Save time drafting, negotiating and litigating franchise agreements with the updated Covenants Against Competition in Franchise Agreements, Third Edition. Since franchising has become an international industry in the past decade, this updated Third Edition has been expanded to include chapters on Canada and Mexico, making this a complete North American publication.

This publication provides a framework for comparative analysis of this critical topic in the franchise context throughout North America. This book gives franchisors, franchisees and their counsel a single source for the most current franchising statutory and decisional law in each of the 50 states, Washington, DC, Puerto Rico, U.S. Virgin Islands, Canada and Mexico.

An outline of issues addressed for each country and state includes:

- Have the courts articulated the “legitimate interests” of the franchisor that will support enforcement of a covenant against competition contained in a franchise agreement?
- What time limitations have courts recognized as reasonable in the franchise context?
- What geographic limitations have courts recognized as reasonable?
- What limitations on activities have courts recognized as reasonable in the franchise context?
- Does the state recognize a difference between in-term and post-term covenants?
- Has the state allowed enforcement of covenants against non-signatories?
- Will the state modify, “blue pencil” or otherwise reduce a covenant found to be overbroad?
- When does a non-compete period begin to run?
- Are there additional nuances in the state’s treatment of covenants in the franchising context?

To order, call the ABA Service Center at (800) 285-2221 or visit our website at www.americanbar.org/groups/franchising/publications.html
It’s Time to Consider Electronically Signing the Franchise Agreement

By Jeremy Liebman Cellairis

Implementing and maintaining a digital signature program is a terrific way for franchise systems to execute franchise agreements and ancillary documents. In this digital age, where parties are signing and scanning most agreements, franchise agreements are no different. Franchisors are beginning to electronically disclose their FDDs, a cost-effective and time-saving solution. Yet, it appears that far fewer franchisors are exploring the use of digital signatures for franchise agreements.

The adoption of the Uniform Electronic Transactions Act (UETA) in most states and the passage of the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. § 7001 et seq. (E-SIGN) at the federal level in 2000, confirmed that electronic signatures have the same legal standing as pen-and-paper signatures, and a contract or record of transactions may not be denied legal effect or ruled unenforceable simply because it is in electronic form. Over a decade has passed since the E-SIGN Act was signed into law, and numerous court cases have fully supported the legal integrity of e-signatures.

While digital signatures in the United States are legal, how do you tie the e-signature to the signatory in court, and is it secure? E-SIGN and UETA provide requirements to establish a valid signature that address: (1) each party’s intent to sign, (2) associating the signature to the document, (3) record retention, and (4) in certain consumer situations, the parties’ consent to do business electronically.

The use of a reputable e-signature provider that warrants its compliance with E-SIGN and UETA can be a very useful tool to ensure the admissibility of an agreement.

Reputable e-signature providers deliver a digitally sealed contract that is verified for authenticity with a third-party certificate authority. A signatory may be required to first answer a series of personal questions and enter identifying information prior to opening the document. The software tracks the IP address and location of where the document was signed. This is substantial evidence compared to a handwriting expert working with a barely legible and scribbled signature (with the “print name” line likely left blank).

E-signature providers can require that all mandatory fields be completed or e-signed before the document is accepted and sent for counter-signature to the franchisor. This virtually eliminates issues where agreements are returned with blank exhibits, unsigned amendments or “artwork,” such as cross-outs in pen buried in the document.

Of course, an area representative model does not solve all problems that are typical to a master relationship either. One example is who performs and pays for all of the daily supervision and control of the local unit franchisees. If a master is not interposed into the model, then of course the franchisor itself must bear all of these costs and must invest the time itself that it takes to deal with the local franchisees on an ongoing basis.

Foreign expansion is not a walk in the park, and what worked “at home” may not work abroad. Traditionally, expansion internationally has used a master franchise model. Given the number of master franchisees who fail, and the costs of such failures to franchise systems, maybe it is time to re-think this strategy and consider area representatives as an alternative.
In accordance with the Forum’s By-Laws, the annual Governing Committee election process begins with the appointment of a Nominating Committee by the Forum Chair. The committee, which is headed by the Immediate Past Chair, is responsible for recommending candidates to fill open positions on the Governing Committee. Joseph J. Fittante, Jr., Chair of the Forum, is pleased to announce the appointment of the following members to the 2013 Nominating Committee:

Ron Gardner, Chair
Dady & Gardner P.A.

Shelley Spandorf
Davis Wright Tremaine LLP

Jon Solish
Bryan Cave LLP

Jane Cohen
Law Offices of Jane Cohen LLC

Himanshu Patel
Zarco Einhorn Salkowski & Brito, P.A.

This year’s Nominating Committee will recommend candidates for four Member-at-Large positions on the Governing Committee, all beginning August 2014, when Kerry Bundy, James Goniea, Eric Karp and Kathy Kotel, as Governing Committee members, complete their terms.

An election to fill these positions will take place at the Forum’s Annual Business Meeting, which will be held in conjunction with the 36th Annual Forum on Franchising. This meeting will take place on Thursday or Friday, October 17th or 18th, 2013, in Orlando, Florida. Forum members wishing to recommend candidates to fill these positions should convey their comments to Ron Gardner no later than May 15, 2013. Ron’s email address is rkgardner@dadygardner.com.

Have a great spring. Here’s to all the optimism that comes with a new baseball season!
The Benefits of Membership
By Kathryn M. Kotel
Forum Membership Officer

Why should you become a member of the Forum on Franchising? I know budgets are tight and money for memberships is scarce for many lawyers today. And while Forum membership isn’t expensive, you first have to join the ABA and then a section before you can join the Forum. I’ve heard many people say it’s just too expensive to join. But I say the benefits—both tangible and intangible—greatly outweigh the costs.

As the Membership Officer of the Forum, I feel compelled to first remind you of the wide variety of tangible benefits offered to members of the Forum on Franchising. These include discounts on Annual Forum registration costs, discounts on the Forum’s many publications, our premier Franchise Law Journal, The Franchise Lawyer, and the Membership Directory that lists members alphabetically and geographically. With all of these resources readily available, you can be assured you’ll be ready to handle the next franchise issue that winds up on your desk.

As required by the Forum’s bylaws, we surveyed our members in mid-2011. In this survey, our members said the Forum’s meetings and conferences were the most important benefit to them. This includes our Annual Forum in October, and the teleseminars and webinars offered by the Forum. Members also said our publications and CLE credit are important benefits.

I’ve belonged to the Forum for over 20 years. The benefits described above have been and remain useful tools in my practice. However, I think the value of my Forum membership is more intrinsic. As a result of my involvement in the Forum over the years, I have had the pleasure of developing strong, lasting friendships with many franchise lawyers across the country. Like me, some of these lawyers are in-house counsel. This has allowed me to develop a good network of resources that I can reach out to when I need answers to questions. I’m sure others have dealt with before. Others are lawyers representing franchisors that I have turned to for assistance on a variety of matters that have arisen over the years. Still others are predominantly franchisee lawyers who have provided me with good insight into the franchisee point of view on many issues and helped me to view each issue from all sides of the matter.

Are you a member of the Forum yet? If not, I encourage you to join. If you are already a member, do you know other lawyers who practice franchise law? Encourage them to join so they can start experiencing the benefits of membership too. And regardless of whether you are a member or not, I strongly encourage you to get involved with the Forum. There are plenty of opportunities to write or work on one of our various committees. Not only is this good for your practice, but it will get you started on developing your own lifelong friendships in the Forum.

Navigating the Unknowns of the PPACA
Franchisors, in addition to demanding compliance with the law, should assist its franchisees in obtaining information on how to comply with the PPACA and should provide guidance so that franchisee’s policies conform with the system’s brand standards. However, franchisors should refrain from exerting control over franchisee’s employees’ hours or providing health insurance plans directly, so as to avoid possible claims of vicarious liability. Further, franchisors should be aware that the PPACA uses the common law standard to define “employer”—actual control is not required and it is sufficient that the employer has the right to control or direct an employee. Although it is unknown at this point how the PPACA will fully affect the franchise community, a measured approach and strategic planning can help remove some of the uncertainty for franchisors and franchisees, ensuring that you will be fully ready come January 1, 2014.
36th Annual Forum on Franchising – Franchising in Full Animation

By Diane Green-Kelley and Eric 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, 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 — the World of Harry Potter at Universal Studios Orlando. Join us at Universal Studios 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. Watch the dolphins swim in their beautiful habitat 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, where volunteers will sort school supplies and perform other projects. AGFT puts free school supplies into the hands of our community’s highest-need schools and classrooms, providing necessary tools to students who otherwise would have none while making sure teachers don’t have to purchase them with their own money.

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.

Watch for the meeting brochure in May 2013.
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