The main issues we consider for any Forum program or other Forum endeavor are whether it supports our mission to be the preeminent forum for the study and discussion of the legal aspects of franchising and whether it will benefit our membership. We have many exciting things happening in 2014 that do both, and I want to take this opportunity to share them with you.

**Annual Meeting**

First, the 2014 Forum will be held October 15–17, in Seattle in the beautiful Pacific Northwest. This year’s co-chairs, Jim Goniea and Will Woods, with help from their friends and colleagues, have developed a truly first-class program. You will see some changes to our programming this year, which you can view by visiting http://www.ambar.org/cuttingedge or by visiting our ABA webpage at http://www.americanbar.org/groups/franchising.html.

This year’s annual meeting begins at noon on Wednesday, October 15, with the Forum’s five-hour, comprehensive, intensive program, Fundamentals of Franchising®. The second intensive program we will offer is Advanced Issues in Mergers and Acquisitions in Franchise Systems. Participants in this intensive will receive the Forum’s newest book, Mergers and Acquisitions of Franchise Companies, Second Edition.

On Thursday, October 16, Amy Cuddy, Assistant Professor in the Negotiation, Organizations & Markets Unit at Harvard Business School, will speak at the plenary about how non-verbal communications influence perceptions and outcomes in negotiation.

Our Annual Franchise and Distribution Law Developments plenary program on Friday, October 17, will review the seminal cases from last year.

On Thursday and Friday, there will be 24 workshops exploring current legal and business challenges facing franchising. These workshops range from basic to advanced topics and cover a wide range of subjects, from consumer class actions to the legal complexities of franchising in the health care sector to how to get an international franchise deal done. This year, we are also offering a 25th workshop, a corporate counsel roundtable open exclusively to in-house lawyers. This panel will be led by a tremendous group of in-house lawyers and will be offered only once, so please do not miss it.

We also are looking forward to the social events this year. We will host a welcome reception at the hotel on Wednesday night. But we are offering

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FTC’s Data Security Authority Survives Challenge in Wyndham

By Matthew B. Gruenberg, Barnes & Thornburg LLP and David W. Nelson, Barnes & Thornburg LLP

A recent ruling in the Federal Trade Commission’s closely watched data security lawsuit against Wyndham Worldwide Corporation (Wyndham) could bolster the FTC’s efforts to regulate data security. Denying a motion to dismiss in Federal Trade Commission v. Wyndham Worldwide Corporation, Case No. 13-cv-01887, the U.S. District Court for the District of New Jersey upheld an FTC civil complaint against Wyndham and its subsidiaries arising from data-security breaches on computer systems operated by Wyndham and its franchisees.

The court’s decision affirms the FTC’s authority over data security under Section 5 of the Federal Trade Commission Act. This ruling should be a wake-up call for all businesses that handle consumer data, but it has particularly important implications for franchisors, who now must evaluate their obligations to ensure proper data-security practices on franchisee-controlled computer systems that connect to a franchisor-controlled or shared network.

Acts Deemed “Unfair,” “Deceptive”

Through its subsidiaries, Wyndham has franchise agreements with approximately 75 independently owned hotels and management agreements with approximately 15 independently owned hotels. The agreements require these “Wyndham-branded hotels” to purchase designated computer systems and configure them to Wyndham’s specification. These “property management systems” are used by each hotel to handle reservations, check guests in and out, assign rooms, manage room inventory, and handle payment card transactions. They store consumer information, including names, contact information, and credit card information, on the Wyndham-branded hotels’ servers.

Each Wyndham-branded hotel’s system is then linked to Wyndham’s corporate network, including its central reservation system. The property management systems are owned by each individual Wyndham-branded hotel, run off of each hotel’s own servers, and operated by each hotel’s own employees. Nevertheless, the FTC alleges that Wyndham “managed” the systems because it had exclusive administrative access and set all rules for the systems, including password requirements that allowed the Wyndham-branded hotels’ employees to access the systems.

On three separate occasions between April 2008 and January 2010, cyber-attackers gained unauthorized access to Wyndham’s corporate network and to many of the Wyndham-branded hotels’ property management systems. Through that access, the attackers obtained consumer information stored on the Wyndham-branded hotels’ property management systems. The FTC alleges that more than 619,000 consumer payment card account numbers were compromised in these data breaches, resulting in more than $10.6 million in fraud.

The FTC attributed these data breaches to Wyndham’s failure to provide reasonable security for the consumer information maintained both in its corporate network and on the Wyndham-branded hotels’ property management systems. The FTC alleges that these failures were “unfair,” and that Wyndham’s representations on its website that it had implemented reasonable and appropriate security measures were “deceptive” under Section 5(a) the FTC Act.

Court Upholds FTC’s Authority under Section 5(a) of FTC Act

With the support of several trade organizations, including the International Franchise Association and the Chamber of Commerce of the United States, Wyndham brought a motion to dismiss, challenging, in part, the FTC’s authority to regulate a private company’s data security practices as “unfair acts or practices” under Section 5(a) of the FTC Act. Section 5(a) defines an “unfair act or practice” to include one that “causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and [is] not outweighed by countervailing benefits to consumers or to competition.” 15 U.S.C. § 45(n).

Relying primarily on FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120 (2000), in which the United States Supreme Court found that the Food and Drug Administration (FDA) did not have authority to regulate tobacco products because Congress intended to exclude them from the FDA’s jurisdiction, Wyndham argued that recent data-security law—including the Fair Credit Reporting Act, the Gramm-Leach-Bliley Act, the Children’s Online Privacy Protection Act, and the Health Insurance Portability and Accountability Act—show Congress’s intent to authorize “particular federal
agencies to establish minimum data-security standards in narrow sectors of the economy.” Allowing the FTC to establish general data-security standards for the private sector under Section 5 of the FTC Act would be incompatible with this “overall statutory landscape,” Wyndham argued.

The court rejected this argument, refusing to “carve out a data-security exception to the FTC’s unfairness authority.” In this case, unlike in the Brown decision on the FDA’s authority, the court refused to find that the FTC’s authority over data security was “incompatible with more recent legislation” or that it “plainly contradict[ed] congressional policy.”

Instead, the court concluded that recent legislation dealing with data security complements, and does not preclude, the FTC’s authority. The court also found that Wyndham had received fair notice that “unreasonable data security practices” were “unfair” under Section 5 of the FTC Act, rejecting Wyndham’s argument that fair notice required the FTC to publish formal rules and regulations before bringing an enforcement action. The court explained that the contour of an unfairness claim in the data-security context must be “flexible,” so that “the FTC can apply Section 5 to the facts of particular cases arising out of unprecedented situations.” Thus, the court concluded, the FTC Act’s test under 15 U.S.C. § 45(n) to determine whether an act is “unfair” (stated above) and the FTC’s many public complaints and consent agreements, as well as its public statement and business guidance brochure, provided adequate notice of the data-security standards under Section 5.

Finally, the court rejected Wyndham’s contention that the FTC failed to allege substantial, unavoidable consumer injury sufficient to show that Wyndham’s practices were “unfair” under 15 U.S.C. § 45(n). The court concluded that the FTC’s allegation of small losses to many consumers constituted “substantial injury to consumers.” More notably, the court concluded that the FTC had pled that Wyndham “caused” substantial injury to consumers through allegations that Wyndham’s unreasonable data-security practices allowed the cyber-attacks to occur, which ultimately resulted in consumer injury.

**Privacy Policy Claim Survives**

The district court also denied Wyndham’s effort to dismiss the FTC’s “deceptive” practices claim. The FTC alleged that statements on Wyndham’s website and in its privacy policy that it had “implemented reasonable and appropriate measures to protect personal information against unauthorized access” were false or misleading and constitute deceptive practices under Section 5(a) of the FTC Act. Wyndham argued that these statements were not deceptive because they were expressly limited to information maintained on Wyndham-controlled computer systems. By contrast, the consumer information taken in the cyber-attacks was stored on the Wyndham-branded hotels’ property management systems.

In rejecting this argument, the court concluded it could not make a determination at the pleading stage that Wyndham and the Wyndham-branded hotels are, as a matter of law, separate entities with their own computer networks and data-collection practices. Moreover, the court found that a reasonable consumer would not have understood Wyndham’s statements to include only data-security practices on Wyndham’s corporate system and not on the Wyndham-branded hotels’ systems.

**Implications for Franchisors**

Even though Wyndham has filed an interlocutory appeal to the Third Circuit, and even though this is merely a district court order on a motion to dismiss, the Wyndham decision will likely add momentum to the FTC’s recent efforts to regulate data-security practices through enforcement actions over data-security breaches (most of which are now resolved through potentially costly consent decrees).

Yet the decision provides little guidance for businesses regarding what constitutes “reasonable” data-security measures. The court acknowledged that this is a fact-specific inquiry that will vary from business to business. Despite this limited guidance, however, businesses would be wise to reevaluate their data-security practices to identify and address potential risks to their systems.

For franchisors, this may mean ensuring that proper data-security practices are followed by franchisees that connect franchisee-controlled computer systems to the franchisor’s corporate system or to shared systems controlled by the franchisor. The FTC’s allegations against Wyndham are based, in part, on Wyndham’s failure to ensure that the Wyndham-branded hotels implemented proper data-security measures on their property management systems before connecting to Wyndham’s corporate system, as well as on Wyndham’s failure to properly limit access between and among the corporate system, the property management systems, and the internet.

Further, franchisors should consider whether the requirements they establish for their franchisees’ computer systems, or the control they exercise over those systems, may give rise to an obligation to ensure that franchisees are following proper data-security practices, and may give rise to potential liability if there is a data-security breach on the franchisee’s local system.

The authors thank Kristyn Gregor, Barnes & Thornburg, LLP, for her contributions to this article.
Pennsylvania’s Legislation Is Franchisee-Friendliest of All

By Abhishek Dubé, DLA Piper (US)

Advocates of franchisee rights are backing legislation in Pennsylvania that would restrict franchisor practices they deem unfair, protect franchisees’ equity in their businesses, and empower collective actions by franchisee groups. Pennsylvania’s HB 1620 is the most significant and far-reaching effort in any state to tip the balance in the franchisor-franchisee relationship in favor of franchisees.

Proposed last summer by Pennsylvania House Representative Peter Daley (D), a former Quiznos franchise owner, HB 1620 seeks to add a new Responsible Franchise Practices Chapter to the Commerce and Trade title of the Pennsylvania Consolidated Statutes that would:

• Require that franchisors deal in “good faith” with franchisees;
• Restrict franchisors’ power to terminate, not renew, or deny consent to a transfer of franchise agreements without “good cause”; and
• Impose limited fiduciary duties on franchisors, requiring them to “exercise the highest standard of care” in performing bookkeeping, collection, payroll, and accounting services on behalf of franchisees and administering or supervising the administration of advertising funds.

Non-Renewal Limited

Under HB 1620, if a franchisor chose not to renew a franchise agreement, it would have to provide at least six months’ non-renewal notice to the franchisee. A franchisor could elect not to renew in only four circumstances: if termination is permitted for “good cause” (that is, based on a legitimate, good faith business reason); if the franchisor and franchisee agree in writing not to renew; if the franchisor withdraws from distributing its services through franchisees in the relevant geographic market served by the franchisee; or if the franchisor ceases to offer new franchises.

Post-term covenants against competition could be invalidated under HB 1620. A franchisor, after expiration or termination, could not prohibit a franchisee from continuing to engage in business at the franchised location (as long as the franchisee refrained from using the franchisor’s trademarks, trade secrets, or other intellectual property), unless the franchisor purchased the assets of the franchised business for fair market value.

The bill would prohibit franchisors from restricting franchisees’ ability to obtain “equipment, supplies, goods or services used in the establishment or operation of the franchised business from sources of the franchisee’s choosing,” subject to the requirement that “[g]oods and services” may have to meet established uniform system-wide quality standards promulgated by the franchisor. In addition, any supplier rebates would have to be remitted to the franchisees that made the purchases involved.

New Locations Restricted

HB 1620 would restrict a franchisor’s ability to open new locations or new channels of distribution. Before granting or licensing a new franchise or offering goods or services similar to those offered by a franchisee and identified by the same marks, a franchisor would have to give at least 120 days’ written notice to all franchisees in proximity to the proposed new franchise or channel of distribution.

The new franchise would be deemed in “unreasonable proximity” to an existing franchisee if the existing franchisee’s gross sales were reduced by more than 10 percent over the first 12 months of the new franchise’s initial operation. If the new franchise or channel is in “unreasonable proximity” to an existing franchisee, then the franchisor would have to compensate that franchisee an agreed upon amount or an amount based on an appraisal.

A franchisor’s ability to include in its franchise agreements provisions requiring franchisees to mediate, arbitrate, or litigate claims or controversies outside the state in which the franchised business is located would be limited—even though such a restriction on arbitration may violate the Federal Arbitration Act.

A franchisor could be liable for civil penalties of $2,500 per violation of the provisions of HB 1620. Intentional violations would subject the franchisor to criminal penalties.

HB 1620 contains atypical limitations on a franchisor’s right to transfer its business. For example, the transferee would have to “assume the franchisor’s obligations to the franchisee” or “renegotiate in good faith the franchisor’s obligations to the franchisee.” In addition, the buyer of the franchisor’s business would have to possess the experience and financial means to perform those obligations.
As for system changes requested by franchisees, HB 1620 contains a declaration that "the franchisor and the franchisee have the need to make reasonable changes to the franchise system to incorporate new and mutually advantageous products, technologies and methods of doing business." This could be interpreted to require a franchisor to implement changes proposed by a franchisee—or for a franchisee to refuse to make changes mandated by a franchisor. Under this constraint, franchisors may find it difficult to maintain a uniform franchise system.

HB 1620 includes an affirmative obligation to provide initial and continuing training for the life of the franchise. It also imposes a duty of competence on franchisors. For example, it would require that a franchisor have the level of skill and knowledge normally possessed by franchisors in the same business.

Finally, HB 1620 would not allow a franchisor to prohibit a franchisee from joining a trade association or to retaliate or discriminate against any franchisee that does so.

What Is the Future of HB 1620?
The Pennsylvania House’s Consumer Affairs Committee held a hearing on HB 1620 in November 2013. The hearings drew participation by franchise owners, franchisors, and their respective counsel, as well as the Coalition of Franchisee Associations and the International Franchise Association. Representative Daley implied that another hearing may be held during 2014, and observers have said they expect no decision until then regarding whether HB 1620 will move forward.

It is difficult to predict whether there will be any revisions to the legislation before it is reconsidered. Potential changes would, for example, provide exemptions from HB 1620 for existing franchises or for franchises covered by other laws.

If HB 1620 in its current form became law, it would be the strictest franchise law in the nation. And franchisor interests warn that this might prompt them to focus their development efforts on other states.

Party-Appointed Arbitrators: Ethical Concerns
By Peter R. Silverman, Shumaker, Loop & Kendrick

Arbitration, like litigation, is governed by a code of ethics—one not necessarily well understood by litigators. A primer on key provisions in the Code of Ethics for Arbitrators in Commercial Disputes (Code of Ethics) concerning party-appointed arbitrators follows.

The “Party-Appointed Clause” is a popular option in arbitration. It provides for a three-member panel, with each party choosing one arbitrator, and the two chosen arbitrators selecting the third. When you select an arbitrator to serve as a party-appointed arbitrator—or serve as one yourself—it is important to carefully review Canons III, IX, and X of the Code of Ethics.

For starters, the sponsors of the Code of Ethics state in the preamble that “it is preferable for all arbitrators to be neutral, that is, independent and impartial.” Indeed, the Code of Ethics presumes that all arbitrators are neutral absent agreement to the contrary. That said, the sponsors realize that parties may prefer to appoint non-neutral arbitrators. Accordingly, they provide a separate Canon X to govern non-neutral arbitrators, referred to in the Code of Ethics as “Canon X arbitrators.”

The Code of Ethics obligates party-appointed arbitrators to determine their status by reviewing the arbitration clause governing their appointment. They may also consider the parties’ course of conduct and the trade’s custom and usage. If the party-appointed arbitrators conclude they are not intended to be neutral, Canon IX of the Code of Ethics requires them to inform the parties and the third arbitrator of that.

The information parties may communicate to third-party arbitrators before and after they are selected is governed by Canon III of the Code of Ethics. Parties may communicate with prospective third-party arbitrators about the parties, counsel, witnesses, and the general nature of the dispute, but they may not communicate about the merits. Parties may communicate with their selected third-party arbitrator about whether the third-party arbitrator is neutral, the selection of the third arbitrator, compensation for the party-appointed arbitrator, and logistics.

Canon X arbitrators are allowed to be predisposed toward the party who appointed them. If Canon X arbitrators plan to communicate with their appointing parties, they should inform the parties and the third arbitrator. They may communicate about anything other than arbitrator deliberations on a submitted issue, any matter after the record is closed, or any final or interim decision before their decision is released.
Franchising in Africa: Opportunities and Challenges
By Babette Marzheuser-Wood, Dentons

Africa presents some of the most dynamic markets in the world for franchising. Within the next five years, seven of the 10 fastest growing economies of the world will be in Africa. Foreign direct investment into Africa in 2015 is estimated to reach US$54 billion. Some 200 to 300 international brands are reported to be active in Africa, in addition to a thriving market for indigenous franchise systems ranging from fast food, retail, and hospitality brands to micro franchises, which use single-person franchise units with seed capital to support key infrastructure needs such as mobile phone sales, farming, and doctors or nurses on bikes.

The story of Nando’s illustrates the progress fast food concepts have made in Africa. This concept was launched in 1987, when Robert Brozin and Fernando Duarte bought a restaurant in Johannesnburg called Chickenland that used recipes from the Mozambican–Portuguese community. The business was later renamed Nando’s. Today, the South African chain is one of Africa’s famous brands, with more than 1,000 locations in 30 countries, including Botswana, Mauritius, Namibia, Nigeria, Zambia, and Zimbabwe.

Australian franchisor Cash Converters is another African success story. Cash Converters is the world’s largest specialist in buying and selling second-hand goods and providing fast and easy access to cash. Cash Converters uses a well-thought-out franchise system, with modern retailing practices, to overcome the image of the traditional second-hand dealer. The first South African store opened in 1994 in Parow, Cape Town. Today, South Africa is the fourth-largest territory for the brand internationally, with 65 units.

Tough Challenges for Franchisors
But these encouraging stories should not be taken as evidence that franchising in Africa is easy. On the contrary, franchisors face tough challenges. Africa’s standards for protecting intellectual property remain substantially below those of Western economies. Many African countries have enacted intellectual property laws, but enforcement can be difficult. Equally, although anti-corruption and anti-bribery laws are in place, enforcement is sporadic. Only three African countries—Rwanda, Botswana, and the Cape Verde Islands—scored 20 points or more (out of a possible 100) in the Transparency International Annual Report on perceived corruption. Withholding taxes of 15% to 20% erode margins. And registration requirements in some countries, such as Nigeria and Uganda, impose unrealistic restrictions on franchisors.

This article considers the countries that are attractive for foreign franchisors and the legal considerations that impact the decision to franchise in Africa.

Top Countries for Franchise Investment
Africa has a 300-million-strong middle class, with 16 million households having disposable incomes of $5,000 a year or more. From an economic perspective, top countries to target for franchised businesses in Africa include oil-rich Nigeria and fast-growing Kenya, Uganda, Mozambique, Ethiopia, and Rwanda (which have GDP growth of at least 5% annually). South Africa, Cameroon, and Kenya are also attractive because they have a high number of households with relatively high disposable incomes.

Political stability is another important consideration. With four decades of uninterrupted civilian leadership and significant capital investment, Botswana is one of the most stable economies in Africa. The Cape Verde Islands also have a stable democratic government, but the commercial potential of these dry and remote islands is low.

Nigeria, poised to become Africa’s largest economy, is already a magnet for foreign investment and is widely expected to be the next big market for franchise brands. But terrorist threats and fears of insurgency in the wake of the 2015 election affect investor confidence. (Some say that terrorism can reduce GDP growth by up to 1%.)

Egypt, with a population of 80 million, a growing middle class, and a per capita GDP of $3,000, is commercially attractive. The political situation there appears to be stabilizing, and franchisors should be returning. Ghana has been politically stable since 1981. With a per capita GDP of $1,600, it remains relatively poor, but it has a rich, diverse resource base and an advanced industrial manufacturing sector. Mozambique’s economy has grown at an average annual rate of 9% for most of the past decade—one of Africa’s strongest economic performances. But despite this impressive progress, 52%...
of its population remains below the poverty line.

Franchising is booming in post-apartheid South Africa, which remains an interesting target for global brands. After robust growth from 2004 to 2007, the credit crunch and global economic crisis led to a devaluation of the South African Rand. Still, with a population of 51 million and per capita GDP of $7,500, South Africa is a major global economy. An impressive 12% of South Africa’s GDP is attributed to franchising—2% more than in the United States, where franchising is estimated to represent 10% of the economy.

Finally, Zambia should be of interest. The World Bank re-classified it as a middle-income economy, and two internationally recognized credit agencies assigned it a B+ sovereign credit rating.

**Ten Countries Have Franchise Laws**

Franchise laws exist in at least 10 African countries. South Africa and Tunisia have express franchise laws. Kenya and South Africa apply certain aspects of their Consumer Protection Acts to franchising. African nations have no classic franchise registration laws, but registration requirements arise in relation to technology transfer and commercial agency laws. In Nigeria, Ethiopia, and Uganda, for example, franchise agreements may have to be registered as technology transfer agreements. Government agencies in these three countries may refuse to register an agreement if it contains “black-listed” provisions that affect the franchise relationship. A number of African countries with a Portuguese or Middle Eastern heritage apply commercial agency laws to franchise agreements, including Angola and Egypt, but not the Cape Verde Islands. In Mozambique and South Africa, franchise agreements must be submitted to the National Reserve Bank for examination and approval.

**South Africa**

South Africa’s Consumer Protection Act 2008 (CPA) affords franchisees many of the protections intended for consumers. The statute provides that franchise agreements must be in writing, in plain, understandable language. A franchise agreement is broadly defined to include both the traditional concept of franchising and certain licensing and distribution arrangements. The CPA requires franchisors to disclose: basic information about the franchisee and its business history; evidence of trademark registration; information about the franchise network, including a list of franchisees in Tunisia; a franchisee’s required investment and fees; and the franchisee’s financial statements. Disclosure must be made 20 days before a franchise agreement is executed.

**Kenya**

Kenya’s Consumer Protection Act (CPA) protects franchisees against excessively one-sided contractual agreements. Terms that are “so adverse to the consumer as to be unacceptable” can be challenged under the statute. Because the CPA is so recently enacted, (in December 2012), no case law is available to provide guidance on the types of provisions that may be deemed unacceptable. If the CPA is treated as mandatory law, it will apply even if a franchise agreement provides for another nation’s law to govern. Sanctions for violating the CPA include rescission of the agreement and damages, including punitive damages. If an agreement is rescinded, the rescission also terminates all related agreements, including, for example, guarantees and product supply agreements.

**Tunisia**

Tunisia’s Law No 2009-68, through its Article 15, requires franchisors to disclose: basic information about the franchisor and its business history; evidence of trademark registration; information about the franchise network, including a list of franchisees in Tunisia; a franchisee’s required investment and fees; and the franchisor’s financial statements. Disclosure must be made 20 days before a franchise agreement is executed.

**Nigeria**

Nigeria’s National Office for Technology Acquisition and Promotion (NOTAP) requires registration of franchise and license agreements that convey rights
to use trademarks or technical expertise or managerial assistance and staff training—that is, virtually all franchise agreements. See Ch. 62, Laws of the Federation of Nigeria, 2004. NOTAP reviews franchise agreements to ensure that they do not include “blacklisted” provisions. For example:

- The term may not exceed 10 years.
- Franchise fees must be commensurate with the value of the technology or know-how transferred, and may not exceed 5%.
- Quality controls and brand standards may not be unnecessarily onerous, and no unnecessary design changes may be imposed.
- Franchisees may not be obligated to purchase equipment and supplies exclusively from the franchisor and its nominated suppliers.
- The franchisor may not require franchisees to assign at no charge the rights to any improvements made.
- The technology conveyed must be technology not already freely available in Nigeria. Franchisees may not be required to purchase more technology or services than are necessary for the franchised business. And franchisees must be allowed to use complimentary technology, conduct their own research and development, and export their products and services.
- The franchisor’s powers to intervene in franchisees’ business must be appropriately limited.
- Franchise agreements must be governed by Nigerian law, and franchisees may not be forced to submit to the jurisdiction of a foreign court.

If a franchise agreement must be registered with NOTAP, the application must include proof of trademark registration.

Nigeria . . . is widely expected to be the next big market for franchise brands.

The NOTAP “blacklist” captures a broad range of vertical restraints—some typically found in franchising, others more commonly found in product manufacturing licenses and automobile dealership contracts. NOTAP restrictions that often concern franchisors are the 10-year term limit (particularly in the hotel sector), NOTAP’s power to determine whether brand standards are “too onerous,” and the prohibition on exclusive purchasing obligations, which can make it difficult to ensure that uniform standards are maintained.

To avoid the NOTAP restrictions that come with registration, franchisors have devised strategies such as split agreements. In this two-step process, the franchisor registers its trademark license and then enters into a separate service agreement with the franchisee that does not transfer any trademarks or technical expertise and thus, arguably, is not subject to registration. Without registration, however, Nigerian banks cannot facilitate payment of royalties in foreign currency. An alternative fee payment structure then may be needed, permitting the franchisee to use offshore funds to make payments. Another option for franchisors is to register their agreements and apply for a waiver of certain of the NOTAP restrictions. Royalty cap waivers have been granted, particularly in the hospitality industry.

Uganda

Uganda’s Investment Code Act provides that franchise agreements involving the transfer of foreign technology must be registered to be valid. Uganda’s statute imposes the following restrictions on registered agreements:

- Royalties and other fees charged must bear a reasonable relationship to the licensed technology or expertise.
- Liability to pay royalties must cease if the agreement is terminated or the technology or expertise becomes publicly available.
- Royalty fees may be reduced if the licensed technology is also used by a third party.
- The franchisor must provide assistance with marketing programs and with purchasing of any necessary equipment.
- Franchisees must be permitted to continue using the technology after termination and to buy spare parts and raw materials from the franchisor for up to five years following termination.

In addition, registered agreements are not permitted to restrict: the use of competitive techniques; the manner of sale of products and exports to foreign countries; sources of supply; or the way in which any patent or know-how may be used.

Many of these provisions—aimed primarily at technical licenses for industrial property and manufacturing licenses—are inappropriate for franchising. For example, permitting franchisees to continue using the franchise system’s technology after termination would prevent franchisors from enforcing any covenants against competition. In light of such restrictions, franchisors have been reluctant to apply for registration of their agreements. That said,
however, the Uganda Investment Authority (like its Nigerian counterpart) has the authority to exempt an investor from the restrictions and prohibitions referred to above. See Sec. 30, Investment Code Act Cap. 92 Laws of Uganda.

But unlike the Nigerian authorities, who enforce the registration requirement aggressively, the Ugandan authorities are relaxed about the requirement, particularly as to agreements that do not involve the importation of industrial property. In Uganda, it is also easier to argue that a particular franchise agreement is not subject to registration because it does not involve the “transfer of foreign technology into Uganda.” The definition of a registrable “agreement” refers to a “commercial franchise or hire purchase involving the importation into Uganda of technology or expertise” (a narrower definition than that used in Nigeria). Uganda’s registration requirement is under review and is likely to be abolished. In the meantime, many investors and franchisors have chosen not to register their agreements, and Ugandan authorities reportedly permit this practice to continue.

**Ethiopia**

In Ethiopia, the Parliament’s Investment Proclamations of 2002 and 2003 require registration and approval of certain technology transfer agreements by the Ethiopian Investment Commission. See Investment Amendment Proclamation No. 375; www.chilot.me. This applies to franchise agreements that fall within the definition of “technology transfer,” which in turn is defined as “the transfer of systemic knowledge for the manufacture of a product, for the application or improvement of a process or for the rendering of a service including management and marketing technologies but shall not extend to transactions involving the mere lease or sale of goods.” See Art. 14 of Investment Amendment Proclamation No. 375/2003.

This narrow definition is helpful to franchisors because it captures only franchise systems that involve the manufacture of a product, the improvement of a process, or the provision of services. Under this definition, a pure retail franchise would not require registration. By contrast, a service franchise, in which the franchisor typically transfers systemic knowledge for the rendering of a service, including management and marketing techniques, would require registration.

A technology transfer agreement that is not registered has no legal effect. See Art. 30/3 of Proclamation 375/2003. Payments related to technology transfer agreements can only be made out of Ethiopia in foreign currency if an agreement has been registered. See Art. 20 Investment Proclamation 280/2002, www.wipo.int.

**Angola**

Angola’s contract law expressly stipulates that the provisions of the commercial agency law apply to franchise agreements. This law provides that franchisees must be compensated for loss of their client base upon termination. The Angolan courts follow the Portuguese courts in their strict application of commercial agency law to franchising. See João Afonso, Franchising in Angola 2012, LexNoir at 101.

**Egypt**

Egyptian law requires the registration of franchise agreements as commercial agency agreements. Agency is defined as concluding “purchase, sale or lease contracts on behalf of and for the account of manufacturers or distributors.” This definition clearly includes the sale or purchase of goods or services, see www.agentlaw.co.uk, so it may well cover retail franchise systems. But because retail franchisees typically sell products on their own account and not for the account of the franchisor, opinion is divided on whether these franchise agreements fall within the scope of agency law and must be registered. See Joyce G. Mazero and J. Perry Maisonneuve, Franchising in the Middle East and North Africa, ABA 32nd Annual Forum on Franchising, 2009. Egypt’s Agency Law requires franchisors to provide cure notices and permits termination only in the case of a material breach. See id. The agent is also protected against non-renewal. In addition, if a franchise agreement involves the transfer of technology, it must be construed under Egyptian law, and disputes must be resolved by the Egyptian courts or by arbitration in Egypt. See Khaled El Shalakany, UK Practical Law.com, 3-500-5425.

**The Cape Verde Islands**

Despite their Portuguese heritage, the Cape Verde Islands have not followed the Portuguese concept of applying agency laws to franchising. See João Afonso, Franchising in the Cape Verde Islands 2012, LexNoir, at 127.

**Conclusion**

The regulation of franchising in Africa is in its infancy. In some countries, inappropriate technology transfer laws are applied to franchise agreements, creating unnecessary obstacles for franchisors. The emergence of legislation giving franchisees the protections typically given to consumers creates additional difficulty. It is hoped that the South African example, now followed by Kenya, will not take hold in other African countries. Despite the significant legal and political challenges that exist, however, Africa’s dynamic markets present equally significant opportunities for international and indigenous franchise systems to thrive there.
Lawyers typically view the accountant’s role in franchising to be mainly auditing the franchisor’s financial statements and consenting to their use in the Franchise Disclosure Document (FDD). But accountants can play other valuable roles, from developing franchise programs, to advising on certain items of the FDD, to consulting with franchisors and franchisees on business issues.

The FTC Rule requires that the FDD include three years of audited financial statements. A new franchisor may opt to present unaudited financial statements for its first year or partial year (although in California, if unaudited statements are provided, they must be reviewed by an independent CPA). Either way, every franchisor must have an independent CPA perform an audit or review of its financial statements. In addition, the application to register the FDD in franchise registration states must include the auditor’s consent for the franchisor to use the financial statements in the FDD.

Before issuing the required consent, the independent CPA is required by professional auditing standards to read the FDD to identify and resolve any material inconsistencies between the audited or reviewed financial statements and the other information in the disclosure document.

Under the FTC Rule, the Cover Page of the FDD must tell potential franchisees: “If possible, show your contract and this information to an advisor, like a lawyer or an accountant.” Thus, an additional role for accountants is to review the FDD and franchise agreement and consult with prospective franchisees on the advisability of investing in a franchise system.

A prospective franchisor or franchisee should have a business plan, including projections of revenues and expenses, as well as a narrative concerning the business being developed. Accountants can help franchisors or franchisees prepare these business plans.

**Finding an Optimal Formula**

Key elements of the franchisor’s business plan are the amount of the initial franchise fee, rates to be charged for royalties, franchisee contributions to the advertising fund, and other fees and charges. Higher rates and fees generate more revenue for the franchisor but reduce the franchisee’s projected results. Lower rates have the opposite effect, generating better franchisee results but reducing the franchisor’s revenues. Accountants can test alternative rate structures and compare them to similar franchised businesses to help the franchisor find an overall rate structure that balances competing objectives and achieves an optimal formula for all constituents of the franchise system.

One of the most important parts of the FDD is Item 7, presenting numerically, in a table, a high-low range for each major category of the investment to be made by a new franchisee and a high-low range for the new franchisee’s total investment. Franchisors want to make sure the Item 7 table describes the full initial investment cost, but they also may want to keep their estimates as low as possible while still remaining accurate and not misleading. Professional accountants, who frequently advise start-up companies, can offer useful insights on start-up expenses, whether for tax or financial-reporting purposes, for developing projections, or for setting up financial controls. Thus, they can assist in making sure the Item 7 table is accurate and complete.

Another important part of the FDD is Item 19, in which the franchisor is allowed, although not required, to provide information about actual or potential financial performance of its franchised or franchisor-owned units. The information must have a reasonable basis, and the franchisor must have written substantiation. This disclosure must state whether the representation is based on historical results for existing outlets or a subset of the outlets, or is a forecast of a prospective franchisee’s future financial performance. Material bases for the representation must be disclosed, as well as the assumptions that underlie any forecast of future performance. Accountants’ training and experience can be valuable in preparing a financial performance representation that satisfies the rigorous requirements of Item 19.

Most franchisors establish an advertising fund to which franchisees contribute. These aggregated advertising funds often have substantial amounts
of money flowing in and out. Franchisees want to
to know how their advertising contributions are
used, and the franchise agreement typically prom-
ises that the franchisor will provide franchisees
with a periodic accounting (sometimes an audited
accounting) of contributions to and expenditures
from the advertising fund. Preparing this account-
ing or auditing the financial statements of the
advertising fund is another task for accountants.

Item 20 of the FDD presents information on the
historical, current, and projected number of fran-
chised and company-owned outlets. This information
is presented in five tables, covering: system-wide
outlets at the start and end of each of the three prior
years; franchisee transfers to new owners for the
past three years; the status of franchised outlets for
the past three years, including openings, termina-
tions, non-renewals, acquisitions by the franchisor,
closings for other reasons, and the number of units
at the start and end of each year; company-owned
outlets for the past three years, including openings,
acquisitions from franchisees, closings, units sold to
franchisees, and the number of outlets at the start
and end of each year; and projected openings of
franchised and company-owned units for the
coming year. It is not always clear which category
particular franchises or franchise transactions fall
into, and it is important that the tables be presented
consistently from year to year. Accountants can be
helpful in preparing these tables to ensure that they
are accurate and consistent.

Royalty payments, central to any franchise sys-
tem, typically are accompanied by regular reports
from the franchisee of transactions on which the
royalties are based. The franchise agreement typi-
cally reserves a right for the franchisor to audit
the franchisee’s revenues and records. Accountants
can perform these audits to determine whether all
revenues were reported and all royalties and adver-
tising fees paid.

Finally, when litigation arises, there may be a
need for historical financial evidence or expert
opinions about actual or projected damages.
Accountants are well suited to provide these ser-
vice as well.

By taking advantage of these and other services
that accountants can provide, lawyers can improve
their own services to franchisor and franchisee cli-
ents alike.

Message

From the Chair

Continued from front cover

something new afterwards—an opportunity for
random groups of approximately 10 people to
dine together at a “Dutch treat” dinner at one of
the pre-reserved restaurants in downtown Seattle.

The Thursday evening reception and dinner will
be held at the Experience Music Project Museum (the
EMP). On Friday night, you can enjoy a dinner at
Chihuly Garden and Glass. Later, if you want to see
the stunning Seattle skyline from a unique vantage
point, you can request tickets to go to the observation
deck of the landmark Space Needle, which is only a
few steps away from the Chihuly museum.

The Women’s Caucus, Corporate Counsel
Division, and Diversity Caucus have planned a
thoughtful and fun community service event on
Saturday morning. Partnering with Mountains
to Sound Greenway Trust, the Forum will pay it
forward by planting sapling trees to support refor-
esting efforts in and around Seattle.

Free Podcast

We now are offering our members a free podcast
of one of the more highly attended workshops
from the 2013 Orlando meeting, Workshop 2: Fun-
damentals 201: Advanced Drafting of Franchise Agreements. To
access the podcast, click on this link: http://www.americanbar.org/groups/franchising/resources/
forum_technologytips1.html. If you missed this
program in Orlando or just want a refresher on
drafting franchise agreements, please watch.

New Books

Two new publications merit mention. We recently
published Collateral Issues in Franchising: Beyond Registra-
tion and Disclosure. This book is designed to fill in the
gaps and create a guide to “collateral,” but impor-
tant, areas of law that franchise lawyers face each
day. As you will see from the breadth and depth
of the subjects covered—from internet commu-
nications to advertising programs to supply chain
issues—this book should soon become a “must
have” resource for all who practice franchise law.

We are in the last stages of finalizing Merg-
The first edition was published in 1996. In the 18
years since, although many merger and acquisition
issues have remained the same, many issues have
changed and several new issues have arisen. The
second edition addresses them all. You can receive
a complimentary copy of this book by attending the
second intensive program we plan to offer in
Seattle on Wednesday afternoon: Advanced Issues in
Mergers and Acquisitions in Franchise Systems.

Please join us in Seattle. We look forward to
sharing a latte (or two) with you.
Citing Acts of Plaintiffs’ Counsel, Court Rejects Rescission Claim

By James Long, Briggs and Morgan, P.A.

In an inadvertent franchise case, plaintiffs were equitably estopped from rescinding a license agreement based on violations of Minnesota and Wisconsin franchise laws because their counsel had reviewed and revised the agreement, recommended that they execute it even though no Franchise Disclosure Document (FDD) existed, and then asserted 20 months later that the arrangement “undoubtedly was a franchise.” In U-Bake Rochester, LLC v. Utech, 2014 WL 233439 (D. Minn. 2014), a federal district court in Minnesota dismissed the plaintiffs’ claims for rescission based on failure to register and disclose under the Minnesota Franchise Act (MFA) and the Wisconsin Franchise Investment Law (WFIL).

U-Bake involved a license agreement for use of the U-Bake trademark, associated with stores that sell frozen dough and bulk foods. In 2009, while investigating franchise opportunities, plaintiffs visited a store operating under the U-Bake trademark, liked the product and concept, and approached defendants about opening a store. At their initial meeting, defendants told plaintiffs the opportunity “was not a franchise” and encouraged them to have their attorney review a draft license agreement. Plaintiffs’ attorney reviewed the agreement, and his proposed revisions were incorporated in the final version, which he recommended that they sign. No revision was proposed to the agreement’s statement that the relationship “is not a franchise relationship.”

Plaintiffs should not now be allowed to use the franchise laws as an escape hatch.

Before plaintiffs signed the agreement, their banker requested a copy of the FDD. Defendants told plaintiffs there was no FDD because this was not a franchise. Plaintiffs submitted a business plan to the Small Business Association (SBA) in support of a loan application, in which they explained that because this opportunity was not a franchise, “you have the option of partnering with other specialty products or taking a different focus to increase sales at your discretion. You are not limited by a franchise agreement with what has to be on the shelf.”

Plaintiffs executed the license agreement and opened a U-Bake store. Their sales were strong in the first year but then declined sharply. After operating for 18 months, plaintiffs learned that another store owner in Minnesota had sued defendants for, among other things, violating the MFA and the WFIL by failing to register and disclose. (Those claims were later dismissed on statute of limitations grounds.) After learning of that lawsuit, plaintiffs consulted the same attorney who had advised them to sign their license agreement. That attorney notified defendants that their arrangement with plaintiffs “undoubtedly constitutes a franchise under Minnesota law,” and demanded rescission.

Using that same attorney’s firm, plaintiffs subsequently filed a lawsuit seeking rescission of the license agreement under the MFA and the WFIL for violation of registration and disclosure requirements. Both statutes require any entity selling franchises to register with the state and give franchisees an FDD in advance. Minn. Stat. §§ 80C.02, 80C.06, subd. 1; Wis. Stat. §§ 553.21, 553.27(4). Defendants were not registered as a franchisor in either state and provided no FDD to plaintiffs.

On cross motions for summary judgment, defendants argued that the conduct of plaintiffs and their attorney estopped them from seeking rescission under either state’s franchise statute. Defendants relied on Clapp v. Peterson, 327 N.W.2d 585, 587 (Minn. 1982), which held that “equitable defenses are available to a defendant in an action for rescission based on a technical violation of the Minnesota Franchise Act.” The Clapp court rejected a rescission claim against a franchisor who violated the MFA by presenting plaintiff with a copy of an FDD on the day the franchise agreement was executed, rather than seven days in advance. The court deemed this a “technical violation” that “resulted in no harm” to the franchisee. It would not be equitable for the franchisee to reclaim money paid for benefits of the franchise agreement (such as training and advice) that the franchisee had accepted for 22 months, the court concluded. Id. at 587. The same rule applies under the WFIL. See Sterling Vision DKM, Inc. v. Gordon, 976 F. Supp. 1194, 1200 (E.D. Wis. 1997) (holding that even where a franchisee is entitled to recover under the WFIL, “the court must consider whether the . . . equitable defenses of...”)

James Long, Briggs and Morgan, P.A.
waiver or estoppel would make rescission unjust”).

**Court Holds Attorney’s Knowledge Should Be Imputed to Plaintiffs**

The U-Bake court, in holding that equitable estoppel barred rescission, focused on the facts that:

- Plaintiffs’ attorney contributed to the license agreement (by recommending changes and revisions that were incorporated in the final version) and recommended that they execute the agreement;
- Before plaintiffs executed the agreement, their attorney was aware of the factors they later relied on to claim this was a franchise;
- In his letter demanding rescission, plaintiffs’ counsel expressed his knowledge of the type of business arrangement that constitutes a franchise;
- Plaintiffs left intact the provision expressly stating that the business relationship is not a franchise; and
- Plaintiffs submitted a business plan, as a required element of getting an SBA loan, expressly stating that the business was not a franchise and touting the benefits of not having a franchise arrangement.


The court held that the plaintiffs’ attorney’s knowledge concerning whether the licensing agreement constituted a franchise should be imputed to plaintiffs. Moreover, the fact that the attorney knew the type of business arrangement that constitutes a franchise was undisputed at summary judgment, because the attorney, when deposed, refused to answer any questions based on his clients’ assertion of the attorney-client privilege. Thus, the only evidence in the record was the attorney’s subsequent letter, stating that the license agreement undoubtedly constituted a franchise. Id. at *6 n.5.

Considering the equities, the court concluded: “Defendants will be materially harmed if Plaintiffs are now allowed to assert claims that are entirely inconsistent with their earlier representation and conduct” and “should not now be allowed to use the franchise laws as an escape hatch to undo a business decision they now regret.” Id. at *6-7.

The court rejected plaintiffs’ argument that the equitable estoppel defense was barred by the antiwaiver clauses in the MFA, Minn. Stat. § 80C.21, and the WFIL, Wis. Stat. § 553.76. The court distinguished estoppel from contractual waiver, finding that defendants’ defense was based on the fact that plaintiffs “engaged in conduct that estops them from now claiming a violation” of the franchise statutes. Id. at *5.

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**Message from the Editor-in-Chief**

**By Corby Anderson, Nexsen Pruet, LLP**

Like ABC’s Wide World of Sports back in the day, THE FRANCHISE LAWYER “spans the globe, to bring you the constant variety of” franchising. In this issue:

- You will get a report on the latest ruling by a federal court in New Jersey refusing to dismiss the FTC’s complaint against a hotel franchise over data-security breaches.
- You will get an analysis of the most franchise-friendly legislation in the nation, now pending in Pennsylvania.
- You will tour some of the most dynamic markets in the world for franchising, with an overview of the opportunities and challenges posed by the legal, business, and political climate in the countries of Africa.
- You will learn why a federal court in an inadvertent franchise case refused to rescind an agreement in violation of Minnesota’s and Wisconsin’s franchise laws.
- In the latest “Pointers & Pitfalls” article, a group of lawyers and accountants will challenge your thinking on the roles accountants can fill in franchising.
- In a feature new to this issue, the “Litigators’ Corner,” you will get a primer on party-appointed arbitrators.
- On the Forum front, you will get the latest news on events planned for this year’s meeting, in Seattle, a free podcast, and two new publications, as well as an in-house counsel’s perspective on the benefits of membership.

Through these articles, our authors share their views and experiences with you. If you want to learn more, to ask questions, or to share your own views and experiences with them, consider reaching out by phone or email. Given our space constraints, we cannot list authors’ contact information in our issues, but that information is only a click or two away on the internet.

And we hope you will decide to share your views and experiences with the broader audience that THE FRANCHISE LAWYER provides by writing an article yourself. You will be glad you did.
U-Bake clarifies Minnesota and Wisconsin law on applying equitable defenses to statutory franchise rescission claims in two respects: First, the decision arguably broadens the scope of “technical violations” to include instances in which defendants neither registered nor attempted to register the “franchise” and never provided any type of FDD to plaintiffs. Id. at *7. Second, the decision highlights how an attorney’s review of an agreement later claimed to constitute a “franchise agreement” can affect subsequent efforts to rescind the agreement.

Before U-Bake, only one Minnesota case had applied estoppel to bar a rescission claim based on the knowledge and conduct of the plaintiff’s attorney. In Benson v. Sbarro Licensing, Inc., Bus. Franchise Guide (CCH) ¶ 7967 (Minn. 2d Jud. Dist. 1983), counsel for plaintiff negotiated changes to the agreement and knew that defendant was not registered as a franchisor and had not given plaintiff an offering circular (now an FDD). The Benson court imputed counsel’s knowledge and actions to its client and barred the claim for rescission of the franchise agreement based on the equitable defenses of waiver and estoppel. Id.

The U-Bake decision provides support to defendants who face franchise claims from plaintiffs represented by counsel who did not object to the lack of franchise disclosure information when they entered into the arrangement. The decision also provides a warning of the risks plaintiffs face when they wait to allege a franchise claim until they see if the business relationship is successful.

Editor’s Note: The author was counsel of record for defendants in U-Bake Rochester.

The Benefits of Membership: An In-House Counsel’s Perspective

By Sherin Sakr, Kahala

When asked to write an article about the benefits of membership in the ABA Forum on Franchising from an in-house perspective, my first inclination was to poll the members of the Corporate Counsel Committee and seek their input on the benefits they identify with membership. Not surprisingly, many of our answers were similar.

One of the biggest benefits of membership from an in-house perspective is access to resources—not just to written materials but also to human resources. The annual meeting and the Forum’s books and publications, including The Franchise Lawyer, and the Franchise Law Journal, help keep in-house counsel abreast of changes in the law and current trends in franchising. Often, as in-house counsel, our resources are limited, and our ability to research issues is restricted by budgetary and time constraints. The Forum provides a “one-stop shop” to access authoritative and reliable materials that address many of the issues we deal with daily. The ability to electronically search papers from prior annual meetings and previously published articles alone is worth the price of membership.

Add to that the value provided by the listserve, which not only lets us leverage the knowledge of our peers and other franchise professionals, but also lets us search the archive of previous exchanges for an additional perspective on issues we face today. Participation in the listserve allows in-house counsel to stay current with local trends and to pick the collective brain of some of the most experienced franchise lawyers in the industry. It is also a great referral source when dealing with a particular issue or expanding into a new market.

Networking opportunities are an equally important benefit of membership in the Forum, especially for in-house counsel. The Forum’s annual meeting provides a venue where in-house counsel from various industries can network with one another, form lasting friendships, and compare best practices with other attorneys who may be facing similar issues in their respective industries. The ability to connect with other in-house counsel in the franchise industry and to leverage their knowledge and expertise is priceless. I often exchange emails with in-house counsel I have met through the Forum to seek their advice and learn from their experiences on topics ranging from document retention programs, to Foreign Corrupt Practices Act policies, to expansion into a new country. Many of us do not live in markets dense with other franchise companies that we can turn to for input on an issue we may be facing. The Forum makes it possible for us to connect with others similarly situated in the franchise community, which helps us be better counsel to our respective companies.

Without a doubt, membership in the Forum makes me a better lawyer and gives me the tools I need to better serve my company. ■
Collateral Issues in Franchising: Beyond Registration and Disclosure

Edited by Kenneth R. Costello

In addition to counseling their clients on disclosure, registration and other basic franchising concepts, franchise attorneys handle a wide variety of “collateral,” but essential, areas of law on a daily basis. These can range from internet communications to advertising programs to supply chain issues. In this book, each chapter addresses a category of concerns and offers insightful analysis of important aspects of the franchisor-franchisee relationship.

Topics include social media, search-engine optimization and other internet concerns; franchise sales relationships; third-party financing; the franchisor’s corporate and business structure and intellectual property; real-estate issues such as zoning, permits, building code compliance, signs, environmental issues and due diligence, and real estate financing; regulation of advertising and telemarketing; and supply chain management and logistics; among others.

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