ETHICAL ISSUES FOR ATTORNEYS AND OTHER PROFESSIONALS IN FRANCHISE COUNSELLING

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ETHICAL ISSUES FOR ATTORNEYS AND OTHER PROFESSIONALS IN FRANCHISE COUNSELLING*

I. OVERVIEW

For reasons that are not easily explainable or obvious, at least to these authors, ethical, professional responsibility and professional liability issues have emerged from the swamps in the last couple of years in franchising contexts. While any of these topics could be the subject of a workshop by itself, we have elected to give an overview of a selected few of these issues that have recently come to the forefront. Our objectives are first to call your attention to these problems (some might say challenges), and second to encourage you to give thought to how the problems can be effectively anticipated and perhaps avoided in the first place.

If you try to find a common thread among the subjects covered in this paper, let us save you the trouble by simply saying that there is none. Our goal in this paper is to provoke thought among members of the Forum on selected ethical matters, and to disclose how courts have addressed these issues, although very little exists in the way of judicial opinions addressing our subjects in the specific context of franchising. We also will identify some of the literature that has discussed these subjects, and present our own views, based upon our collective 75 or so years of experience, on what some of the key considerations are in crafting a strategy to deal with ethical challenges of a franchise lawyer.

Because every state has its own set of ethics rules (and case law) governing lawyers' professional activities, much of it modeled upon the American Bar Association's Model Rules of Professional Conduct, we rely solely upon the American Bar Association's Model Rules and cite to them extensively. References throughout the paper to a "Rule" means to the ABA Model Rule, and to the Comments accompanying a Rule.

II. REGISTRATION AND DISCLOSURE PRACTICE

A. Due Diligence

It is difficult to argue with the proposition that pre-sale disclosure has become the primary means of regulation in the U.S. franchising environment. There are, of course, laws addressing relationship issues: they were enacted primarily where the law of contracts might not lead to a socially acceptable solution. For example, common law might give the franchisor a right to terminate immediately if the parties have so agreed. On the other hand, many view immediate termination to be unwarranted, subject to abuse, and likely to lead to loss of investment for inappropriate reasons. Thus, we have statutes like the Wisconsin Fair Dealership Law that, in application, may lead to franchisee-favorable results that would not have occurred if only contract law supplied the governing principles. In any event, the focus over the past forty years, since California took the lead in franchise regulation, has been primarily on franchise pre-sale disclosure, secondarily on the registration process, and thirdly on recalibrating the rights and duties of franchisor and franchisees in matters relating to ongoing

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franchise relationships, such as termination, relationships and assignments. How effective disclosure, registration and relationship laws have been is a subject we will leave to others. But these laws are the legal framework within which franchise lawyers practice their profession.

The foundation of pre-sale disclosure is due diligence. For disclosure to be effective, there must be some duty on the person or persons responsible for disclosure to gather the facts that will be disseminated to a prospective franchisee. Due diligence provides protection against the effect of the common law “caveat emptor” concept. In the commercial setting, absent legislative intervention, the buyer must take the steps necessary to ensure that what he (or she) thinks he is buying is in fact what he will be receiving when the dust settles and the transaction is concluded.

In the field of securities law (on which the franchise presale disclosure system was modeled), the concept of due diligence is more than an implied cornerstone of the “going public” process. The securities laws and the resulting case law provides a clear mandate that the parties preparing the disclosure documents, including professionals, might be held liable if due diligence is not properly performed. The liability exposure of professionals is three quarters of a century old in the securities law environment.

In contrast, franchising is the new kid on the block. Only when the securities laws were viewed as being of questionable application to franchise situations did franchise law come into being, beginning with the California Franchise Investment Law, enacted in 1970, effective January 1, 1971.

Today, on the sales side of franchising, disclosure has become embedded in the philosophy of regulation at both the state and federal levels. However, as is the case with issues of franchise lawyer competence, nowhere does one find meaningful guidelines as to what constitutes appropriate due diligence.

The FTC Rule and the Statement of Basis and Purposes, the related Compliance Guide, and applicable state registration laws (which now essentially follow the FTC principles), tell us what our client needs to put into the document, but there are at least two potential practical and ethical traps in the process, from the lawyer’s perspective. First, these sources do not tell us what, other than the prescribed disclosures, are the appropriate additional disclosures necessary to give a prospective franchisee the information he or she would need to make an educated investment decision. In fact, the FTC Rule goes exactly in the opposite direction – stating that nothing other than the prescribed disclosures can be included in a Franchise Disclosure Document (“FDD”). This principle becomes tricky because the states with


4 Cal. Corp. Code § 31000 et seq.


6 Bus. Franchise Guide (CCH) ¶ 6050.

7 Bus. Franchise Guide (CCH) ¶ 6086.

8 16 C.F.R. § 436.6(d); see Chapter 7, Rupert M. Barkoff and Andrew C. Selden, Fundamentals of Franchising at 170 n.118 (3d ed. 2008) (“Fundamentals of Franchising”).
disclosure laws have antifraud provisions\(^9\) included in their franchise registration statutes, but these statutes do not necessarily offer clear guidance on disclosure compliance where there is a material fact affecting a franchise system (or perhaps marketplace) that is not required to be disclosed in the FDD. The Franchise Rule allows for use of an addendum to an FDD to disclose additional information required by a state presale disclosure law,\(^10\) and also contemplates additional disclosure being made outside the FDD, as might be needed to comply with Section 5 of the FTC Act.\(^11\)

The other problem is that no guidelines exist for the lawyer as to what, or how extensive, an investigation he must make to gather information in order to respond to the FDD disclosure requirements. In some cases, it is very easy to confirm the information that must be disclosed to a prospect. For example, the accuracy of most trademark information can be obtained by checking the Patent and Trademark Office records online. If the lawyer preparing the disclosure document is not trademark counsel for the client, it still should not be difficult for him or her to confirm the accuracy of the information provided by the client or for the attorney to ferret out most of this information himself. Litigation disclosure could also be handled in a similar manner even if litigation services were provided by another law firm. And, of course, FDD Item 9 (Franchisee Obligations) and much of Item 11 (Franchisor Obligations) will be obtained from the franchise agreements, with which the lawyer preparing the FDD is likely to be intimately familiar.

But from there it gets very murky. Take, for instance, the background of officers or directors required by FDD Item 2. Other than using a questionnaire to solicit information about the franchisor, what should a franchise lawyer do, if anything, to gather and confirm this information, and how intrusive should the questions addressed to the client be? Can the lawyer accept the client's answers at face value? If an officer of the franchise company has inaccurately presented his credentials in the questionnaire, is it the lawyer's responsibility to ferret out the truth? Also, what about store counts disclosed in Item 20? Does the lawyer have an obligation to interrogate his client on the subject to make sure the information is complete and each unit activity (e.g., purchased, sold, closed down, transferred, etc.) has been accurately characterized in Item 20's charts? Must the lawyer – or should he – audit the client's records?

Considerable secondary-source literature exists on the subject of due diligence,\(^12\) but at most it can be considered best practices – how can the law firm minimize its and its client’s exposure? Unlike the accounting profession, where very detailed instructions are given to

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\(^9\) These generally state that it is unlawful for a franchisor to make an untrue statement of fact, or to omit a material fact that is necessary to make a statement made in connection with disclosure not misleading. Id.

\(^10\) 16 C.F.R. § 436.3(g); 16 C.F.R. § 436.10(b).

\(^11\) 16 C.F.R. § 436.10(a).

\(^12\) For more information on due diligence in franchising, see Arthur L. Pressman and Gregg A. Rubenstein, Lawyers Who Prepare FDDs Do Not Take On Potential Liability to Franchise Buyers, Absent Complicity in a Knowingly False Statement, 12 Franchise Lawyer 4 (Fall 2009); Howard E. Bundy, Are Franchise Lawyers Liable to their Client's Franchisees for Negligent Misrepresentation?, 12 Franchise Lawyer 3 (Summer 2009); Rupert M. Barkoff, Gathering Storm: Franchisees Sue Lawyers, 16 L.JN'S Franchising Bus. & L. Alert 1 (Dec. 2009); Nick Bibby, Franchisor Due Diligence, AllBusiness Franchise Blog (Mar. 21, 2008), http://www.allbusiness.com/company-activities-management/company-structure/7670089-1.html; Jeffrey A. Kolton, Due Diligence Responsibility of Franchise Counsel in a Merger or Acquisition, 23\(^{rd}\) IFA Legal Symposium (1990); Rupert M. Barkoff, Jan M. Davidson & Jerome F. Connell, The Responsibility of House Counsel in the Preparation of Franchise Disclosure Materials, 23\(^{rd}\) IFA Legal Symposium (May 1990); Ann Hurwitz and Mark Rollinson, Due Diligence: What Are the Lawyer's Responsibilities in Preparing an Offering Circular?, 11\(^{th}\) Annual Forum on Franchising ( ABA 1988); Mark D. Shapiro, Due Diligence: Finding the Perfect Franchise Fit for Clients, 8 L.JN's Franchising Bus. & L. Alert 4 (Sept. 2002).
auditors on what procedures to follow in conducting an audit, the franchise lawyer has little authoritative discussion on the subject to provide guidance. Following best practices published by non-official sources, in the way of articles, seminars and the ABA Forum on Franchising ListServe at least gives conduct justification to a lawyer performing due diligence. This presumably could be bolstered by testimony from a respected practitioner if the due diligence question becomes an issue in litigation.

The franchisor lawyer can find some comfort in Rule 2.1, Comment 5, which provides that “ordinarily the lawyer has no duty to initiate investigation of a client’s affairs...”. But “ordinarily” also means that sometimes the opposite is true. No bright line divides those cases.

One question that should not be overlooked is whether the franchisee has an obligation to perform pre-sale due diligence beyond reading the disclosures made in the disclosure documents provided by the franchisor. For a business lawyer representing a franchisee, best practices would dictate that he advise his client to use the disclosure document as only a starting point, and to go beyond the face of the document in making his investment decision. Are prices of required purchases from the franchisor or its affiliates competitive? What type of brand recognition exists in the area where business will be conducted by the prospect? Is the system, or the sector, trending up, or down? What is the franchisor’s attitude towards franchisees: are franchisees business partners or pawns?13

We believe franchisee due diligence is prudent practice, and may be required. The case law suggests that except in the case of disclosures required by federal or state law or regulations, caveat emptor is still the rule.14 In fact, even when information provided by franchisors is furnished and is subject to the disclosure rules, a franchisee cannot always take that information at face value. The reliance must be reasonable. One of the more interesting cases on this subject is Aron Alan, LLC v. Tanfran, Inc.,15 decided by the U.S. district court for the Western District of Michigan. In this case, the franchisor made financial performance representations outside of the FDD, but they were viewed as so unbelievable that the court concluded that there was no way anyone could have reasonably relied upon them. The (possible) moral of the story: if you are going to lie, make it a whopper!

B. Competence

This, too, is a touchy subject. Only one state – California – has focused in recent years on the issue of certifying franchise lawyers.16 In all other jurisdictions, there are no standards specific to the qualifications needed to practice franchise law.


Many lawyers will misjudge their capabilities, and, with respect to franchising, do not even recognize a franchise when they see one, or, for that matter, are not aware of the laws governing franchise (and business opportunities) sales and franchise relationships.

This was the situation in a recent decision by the supreme court of Nebraska. In State of Nebraska v. Orr, the defendant, who had been practicing law for a considerable number of years, accepted an engagement to represent a start-up franchisor in the establishment of its franchise program. Mr. Orr did a nominal amount of reading on the subject. His only practical experience in franchise law was that he had read a franchise agreement for a client sometime in the past. He engaged experienced trademark counsel to assist with federal trademark registration, and that attorney cautioned Mr. Orr that franchise work was specialized. But Mr. Orr proceeded, on the strength of his belief that franchise work was largely a matter of contract drafting.

Mr. Orr's representation did not turn out well. Franchises were sold, many failed, and there was blood on the floor. Lawsuits were filed. Mr. Orr, now having recognized the mess he had fallen into, hired franchise law experts to clean up after the fact. He did what the Model Rules and Commentary suggested, but he did it too late. The Nebraska supreme court disciplined Mr. Orr for violating Nebraska's counterpart to Model Rule 1.1, but given his long-standing and otherwise exemplary record as a lawyer, the court only publicly censured him. This was, no doubt, slim consolation to Mr. Orr; but the penalties could have been far more dramatic.

His decision to take on this representation: Was it a clear blunder? Perhaps, but think back to the number of times each of us has been called upon to do a project in an area which may be slightly outside of our comfort zone. For example, in Georgia, a provision requiring that confidential information be kept confidential will not be enforced as to non-trade secret information unless it has a reasonable time limitation. In other words, at some point confidential information is presumed to go stale. Lawyers in Georgia who fancy themselves either as generalists or specialists may not know of this little twist, and thus commit malpractice by not giving consideration to this factor in drafting a confidentiality agreement, even though drafting such a contract might in most instances be a task that a generalist, or specialist, would typically not hesitate to undertake.

The ethical rules on this issue are interesting. Model Rule 1.1 provides in part:

A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.

The Commentary to Model Rule 1.1 elaborates as follows:

[1] In determining whether a lawyer employs the requisite knowledge and skill in a particular matter, relevant factors include the relative complexity and specialized nature of the matter, the lawyer's general experience, the lawyer's training and experience in

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17 277 Neb. 102, 759 N.W.2d 702 (2009).


19 Model Rules, R. 1.1.
the field in question, the preparation and study the lawyer is able to give the matter and whether it is feasible to refer the matter to, or associate or consult with, a lawyer of established competence in the field in question. . . .

[2] A lawyer can provide adequate representation in a wholly novel field through necessary study. Competent representation can also be provided through the association of a lawyer of established competence in the field in question.

[4] A lawyer may accept representation where the requisite level of competence can be achieved by reasonable preparation. . . .

[5] The required attention and preparation are determined in part by what is at stake; major litigation and complex transactions ordinarily require more extensive treatment than matters of lesser complexity and consequence. . . .

In theory, Mr. Orr was not necessarily off base in accepting the representation. One might say that the problem was in the execution. He did not do enough homework soon enough.

Given this background, several questions come to mind:

- What exactly is the standard of "competence" in the realm of franchise law?
- Do the California certification standards provide a good model for other states to follow?
- Absent certification, how would one prove competency under Rule 1.1, especially when competency will likely be reviewed in the context of a disaster? For readers who are protectionists in nature, keep in mind that "There but for the grace of God go I."
- Should the ABA Forum on Franchising try to develop some standards for competency?
- Should attending programs sponsored by the ABA, the International Franchise Association, the Practicing Law Institute and the like, give a presumption of competence?
- And what about practical experience? 21

C. Franchisor Lawyer Liability To Third Parties

How far does a lawyer's obligations of competency and due diligence extend? Only to his client? Or to third parties such as prospective franchisees, bankers and landlords, for example.

The only case we are aware of that has rendered a final decision relating to this subject in a franchise case is *Courtney v. Waring*. 22 In this case, the plaintiff brought suit against an

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20 *Model Rules*, R. 1.1 cmts. 1, 2, 4, 5.

21 The problem here is the old chicken and egg Catch 22: The best way to become competent is through experience, but to obtain experience, you need to be competent.

22 237 Cal. Rptr. 233 (Ct. App. 1987).
outside-firm lawyer, who was also an officer and director of the franchisor, and survived a motion to dismiss. This meant that the defendant might have been held accountable to a franchisee for inaccurate information included in a disclosure document that the lawyer had helped write. There are hints that similar claims by franchisees against franchise lawyers are on the rise. In fact, two such cases received attention earlier this year.

The first is the *Dream Dinners* case from Washington state. In this case, claims were brought against the attorneys who had assumed professional responsibility for preparing the disclosure documents. The franchisees alleged that the attorneys had stepped beyond the typical role of legal advisors, even going as far as attending the client’s discovery days and, as part of that activity, making financial performance representations to attendees beyond those included in the FDD. Our last check-in on this litigation indicated that settlement is likely. Thus, this litigation may do little to help us understand what the appropriate role of a lawyer in the sales process might be. At a minimum, however, it is a warning to lawyers to be sensitive to this issue.

The second case is *Tyszka v. Make & Take Holding, LLC*, where a New York appellate court held that the franchise lawyer, on the facts presented, could not be held liable for disclosure law violations by the franchisor. This case only construed the New York Franchise Investment Law, noting that by its terms, the statute only imposed liability upon the franchisor’s employees, not on anyone else. The court, however, made it clear that it was not ruling on whether the franchise lawyer could have been held liable to the franchisees under a common law theory.

The wisdom to be drawn from these two cases is that lawyers need to be cautious about the role they are playing in connection with the disclosure/registration process. As lawyers, they are probably protected from direct personal liability for the quality of an FDD as long as they did not have actual information that the disclosure document was inaccurate or misleading, and, second, as long as they are playing the role solely of legal advisors and not that of franchisor executive, sales representative, or franchise broker. This rule should hold true for both inside and outside counsel. Although, in the case of house counsel, it may be considerably more difficult to categorize the nature of the lawyer’s activities as being strictly in one bucket or the other.

III. COUNSELING FRANCHISEES

A. Balancing Client Interests


27 For a vigorous discussion of the issue of how far a lawyer’s duty in preparing an FDD extends, see Pressman, supra note 32, and Howard E. Bundy, *Are Franchising Lawyers Liable to their Client’s Franchisees for Negligent Misrepresentation?*, 12 Franchise L.J. 3 (Summer 2009).
A franchise client, and especially a franchisee or prospective franchisee, is different from most other business clients. Whether a franchisor or a franchisee, the business person or organization is investing (or has invested) in a network business. The network character of a franchise business in many ways transcends the nominal two-party character of most business format franchise agreements.

Although the success or failure of the franchise client’s investment depends to a very great degree on its own business prowess and various external factors, the business fortunes of a franchisor, or of any of its individual franchisees, is also heavily influenced, if not determined, by the ultimate success or failure of the network as a whole. In this vein, it is quite common for franchisors and franchisees alike to refer to the “brand” or the “system” as a collective noun encompassing the entire network of participating businesses.

This consideration alone has an immediate impact on a lawyer undertaking to advise a franchisee or prospective franchisee, as it is not enough to evaluate the labyrinth of legal obligations encompassed in a typical business format franchise agreement, and the many collateral agreements that often accompany it (such as loan agreements, supply agreements, advertising agreements, and confidentiality agreements). Rather, the lawyer must perform that critical evaluation in the commercial context in which the representation arises. The lawyer cannot advise the franchisee or prospective franchisee in a vacuum as if the network did not exist. Item 20 of the FDD, for example, exists for a reason. The reason is to inform the prospective franchisee as to the scale and trends of the franchise system of which the franchised business will be a part.

1. Competence

These factors implicate a number of ethical obligations on the part of the lawyer for a franchisee. First is the obvious challenge of Model Rule 1.1, the duty of competence. Comment 1 identifies the “relative complexity” and the “specialized nature” of the matter as the first factors in assessing the lawyer’s competence to advise a client. In most franchise situations, the “relative complexity” and “specialized nature” of the counseling called for will be relatively high, and will require, in addition to many other things, an assessment of the character, scale and trend of the system of which the franchise will be a part.

Comment 2 to Model Rule 1.1 recites that mere unfamiliarity with a field of law does not disqualify a lawyer from accepting a representation, as the lack of familiarity in theory can be overcome by research and familiarization, or by associating with another lawyer who already is qualified. But that hurdle may be higher when the client is a prospective franchisee, because

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28 External factors include competition, regulatory requirements, trade area demographics, labor costs and availability, supply chain matters, and disasters such as storms or fires.

29 Item 20 requires disclosure in tabular format of a large volume of statistical data about the franchise system in each state in the U.S.

30 Model Rules, R. 1.1 cmt. 1.

31 Id. at R. 1.1 cmt. 2.
the tangle of legal obligations and commercial risks are capable of being overwhelming for an inexperienced prospective investor in a franchised business.\textsuperscript{32}

The lawyer's fundamental duty to provide competent representation to the client requires that the lawyer possess the requisite knowledge, skill, thoroughness and preparation adequate to carry out the engagement.\textsuperscript{33} While a lawyer may carefully define the scope of a representation, any limitation on scope cannot be written so narrowly so as to mask a limited competence and thereby undermine the value of the advice by virtue of excluding material considerations outside the defined scope in such a manner as to impact on the client's interests.

Because franchising represents a unique legal foundation for significant business investment, franchise law has evolved in the United States to be a multi-disciplinary, hence specialized, area of practice. Perhaps the most noteworthy case illustrating the dangers of this character of franchising is \textit{Orr},\textsuperscript{34} where a senior, experienced (but apparently small-town) business lawyer misapprehended an engagement by a start-up franchisor to develop a franchise agreement and UFOC as being largely "a matter of contract drafting." The UFOC later was found to have significant violations of the applicable disclosure requirements of the FTC Rule. One lesson from \textit{Orr} is that even a relatively basic franchising project is a complicated and specialized undertaking requiring substantial skills and experience to carry out competently.

Another instructive case in this area is \textit{Goldsworthy v. Browndorf}.\textsuperscript{35} In \textit{Goldsworthy}, the New Jersey superior court upheld a malpractice claim against a lawyer in circumstances where the lawyer gave extensive advice to a New Jersey franchisee in settlement negotiations with the system's franchisor. When the settlement negotiations failed to produce a satisfactory outcome, the lawyer counseled the client to commence a Chapter 11 reorganization proceeding, which did produce an overall settlement and resolution of the franchisee's situation, but resulted in the loss of his franchised restaurants. The lawyer, it turned out, never advised the franchisee about the possible application of the New Jersey Franchise Practices Act\textsuperscript{36} to the relationship between the client and the franchisor. The lawyer's argument on appeal – that the client had been apprised of the existence of the Act because it was referred to in the UFOC (one can imagine how deeply buried that disclosure must have been in the UFOC's Item 17) – was offset by the client's obvious claim that "he had never read the UFOC."

Another measure of the breadth and complexity of the legal (and closely-related business) considerations required to represent clients investing in franchises is the Forum's own treatise, \textit{Fundamentals of Franchising}.\textsuperscript{37} The third edition consists of seven chapters and seven appendices addressing topics ranging from trademark law, through registration and disclosure issues, franchise relationship laws, antitrust law, and special considerations in counseling franchisees. Only the most intrepid (or perhaps foolhardy) lawyer not thoroughly conversant

\textsuperscript{32} For a more complete discussion of the scope and character of a lawyer's challenges in advising a prospective franchisee, see Chapter 7, \textit{Fundamentals of Franchising}, supra note 8.

\textsuperscript{33} \textit{Model Rules}, R. 1.1.

\textsuperscript{34} State v. Orr, 759 N.W.2d 702 (Neb. 2009); see also supra note 17 and accompanying text.


\textsuperscript{36} N.J. Stat. Ann. 56:10-1 et seq.

\textsuperscript{37} \textit{Fundamentals of Franchising}, supra note 8.
with the art of franchising and the practice of franchise law, would undertake to represent a client in so encompassing a legal environment without exhaustive preparation, or significant involvement by a well-experienced franchise lawyer.

A related consideration appears in Model Rule 2.1. Comment 4 notes that competent representation may call for the lawyer to provide or procure advice from other disciplines, in addition to the strictly legal.\(^{38}\) The comment goes on to observe that in some cases one of the highest values of good legal advice is to reconcile and integrate conflicting inputs from multiple sources in providing advice to the client.

The risk in this area to inexperienced, aspiring franchise lawyers is well-illustrated by Beverly Hills Concepts, Inc. v. Schatz and Schatz, Ribicoff and Kotkin,\(^{39}\) in which an associate in the firm who undertook to perform franchise-related work and “assumed” that her work was being overseen by more senior lawyers in the firm was held to have violated her ethical duty of competence. A lawyer cannot “assume” that competent oversight is being provided by more senior lawyers.

2. Time

Representing a franchisee (or prospective franchisee) also has a temporal dimension. The lawyer must balance both the long-term and short-term goals of the client who invests in a franchise. In other business contexts, the client’s best interests are sometimes well-served by maximizing the short-term gain to be derived from a transaction or occurrence with only passing consideration of extrinsic or strategic factors. But in a franchise, maximizing short-term gains is almost never a prudent course of action, as the franchisee is at least nominally invested for the term of the franchise, often 10 to 20 years or more, and may either own other franchises in the same system, or have aspirations to do so (whether inchoate, or conditionally under some type of development agreement). Advice to a franchisee almost always must take into account both the tactical needs of the immediate situation for which advice has been sought, and consideration of the long-term and broader implications for the client’s investment or aspirations. Going all-out on a tactical dispute with the consequence of alienating the franchisor for the long term will rarely be in the franchisee’s best interest. For a prospective franchisee, the lawyer must balance the initial challenge of wanting to negotiate amelioration of some of the form franchise agreement’s most oppressive provisions, against the concern of having the client be classified from the outset as a “problem franchisee.”

Underscoring the notion that the lawyer for the franchisee cannot simply press to maximize the client’s short-term and immediate gain is Model Rule 1.3. Rule 1.3 requires the lawyer to prosecute the client’s objectives diligently and promptly, but as Comment 1 points out: “A lawyer is not bound . . . to press for every advantage that might be realized for a client.”\(^{40}\) This language reflects an intentional relaxation, both in rhetoric and substance, of the former requirement that the lawyer must be a “zealous” advocate of the client’s interests.\(^{41}\) It’s not that

\(^{38}\) Model Rules, R. 2.1 cmt. 4.

\(^{39}\) Bus. Franchise Guide (CCH) ¶ 11,488 (Conn. Sept. 15, 1998). For discussion of additional ethical traps faced by the franchise lawyer, see Constance T. Fournaris, Kevin P. Hein & Kat Tidd, The Top Hazards Confronting Today’s Franchise Lawyer or, In Other Words, the Easiest Ways to Find Yourself Before a Disciplinary Board, 22nd Annual Forum on Franchising, Vol. 1 Tab W3 (ABA 1999).

\(^{40}\) Model Rules, R. 1.3 cmt. 1.

\(^{41}\) See id.
simple any more. Rule 1.3 acknowledges that the lawyer is expected to use sound judgment in prosecuting the client’s goals, and in the context of a franchise investment, that certainly includes balancing long- and short-term, strategic and tactical, goals, and reconciling conflicting considerations.

3. **Scope of Engagement**

The lawyer’s approach to representing a franchisee (or prospective franchisee) implicates at least two other foundational Model Rules: Rule 1.2(a), and Rule 2.1. To oversimplify, Rule 1.2(a) articulates the fundamental concept that the client determines the goals of the engagement, while the lawyer (with due consultation with the client) determines the means of attaining those goals. Rule 2.1, in turn, requires the lawyer to employ his independent judgment (and to provide candid advice) to the client on how best to achieve the client’s goals. The Rule allows the lawyer, in fashioning the advice given, to go beyond the strictly legal arena to refer to relevant moral, economic, social and political factors. But both case law and scholarly writing interpreting and applying Rule 2.1 suggest that it may be permissive in form, but mandatory in practice, for the lawyer to consider the extrinsic, related, but non-legal, considerations mentioned in the Rule. Obviously, the boundary between “legal” and “non-legal” advice is not a bright line and lawyers who choose to offer advice outside whatever that gray boundary is must tread cautiously. Thus, the lawyer undertaking to advise a franchisee has to take into account the entire kaleidoscopic circumstances that a franchisee invested for the long term in a networked business is likely to encounter.

4. **Groups of Franchisees**

Another complicating factor for the aspiring franchisee lawyer is that franchisees often come in groups. (Perhaps we can paraphrase Lincoln and observe that God must have loved franchisees, because He made so many of them.) The situation may present itself in the form of potential joint clients with common, or at least parallel, interests (at least at the beginning), or as a potential formation of an incorporated or unincorporated collective organization of some type. Franchisee groups may come in forms ranging from incorporated, formally organized, purchasing or marketing cooperatives, autonomous franchisee associations, litigation committees, or simply a rump group of unhappy investors.

No matter how the situation might arise, representation of a potential franchisee group client, whether consisting of two franchisees or 200, complicates the lawyer’s ethical challenges. The lawyer must begin by determining exactly who the lawyer has been engaged to represent. The ethical implications of this question are profound and wide ranging, because of the

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42 Id. at R.1.2(a).
43 Id. at R.2.1.
46 Franchise entities are discussed below at Part IV.
demands of ethical rules requiring a lawyer's loyalty, diligence and confidentiality on behalf of his client.\textsuperscript{47}

In a potential group client situation, the lawyer must be cognizant of Rule 1.7, which prohibits the lawyer from undertaking representations that entail a conflict of interest, or where the lawyer's loyalty to the client may be diluted by other engagements or the lawyer's own personal factors. Divergent interests of members of a group, or divergent goals of the representation, can become a major challenge in a group setting. Rule 1.7(a)(2) speaks to situations where accepting a representation entails a significant risk that a representation will be "materially limited" by the lawyer's responsibilities to another, or a personal interest of the lawyer.

In a franchisee group setting, these issues are almost always present. Issues surrounding representations of an entity (e.g., a co-op, an association, or an unincorporated collection of franchisees) are discussed \textit{infra} in Part IV. Where individual franchisees appear in numbers greater than one, the ethical issues include exploration of the possibility that the interests of one or more clients who are members of the group at the outset may diverge over time.

The franchisee lawyer, of course, must also be cognizant of the more traditional conflict considerations such as the degree to which "positional conflicts" may arise, in which loyal and vigorous pursuit of one client's interests might adversely impact the legal or economic interests of another client.\textsuperscript{48} For example, an engagement that involves intersection with the political realm through lobbying or litigation that challenges the constitutionality of a statute might adversely impact the interest of other clients.\textsuperscript{49}

\section*{B. Protecting Client Information}

Model Rules 1.6, 1.7, 1.9 and 1.18 address the many ethical considerations in the circumstance of a group client. Treatment of information concerning the representation can be especially problematic in a group setting. Rule 1.6 is a surprisingly comprehensive prohibition of disclosure of information concerning the client that is learned in the course of the engagement.\textsuperscript{50} The ethical prohibition is far broader than the scope of confidential information protected by the lawyer-client communication privilege.\textsuperscript{51} The Comments and annotation to Rule 1.6 make clear that the purpose of the Rule is to protect the fundamental value of the

\textsuperscript{47} See Part III.B, \textit{infra}

\textsuperscript{48} Under the \textit{Model Rules}, a purely commercial competitive impact is not a "conflict of interest." Id. at 1.7 cmt. 6. For an in-depth discussion of when a lawyer may permissibly withdraw from representation or is ethically obligated to withdraw from representation of a franchisor or franchisee under \textit{Model Rule} 1.16, see Keith C. Dennen & Janet L. McDavid, \textit{Glass Houses: Ethical Issues Facing Franchise Lawyers}, \textit{Annual Forum on Franchising}, Vol. 1, Tab W9, at 1-9 (ABA 1994).

\textsuperscript{49} See \textit{infra} Part IV.B.

\textsuperscript{50} See \textit{Model Rules}, R. 1.6.

\textsuperscript{51} See id. at R. 1.6 cmt. 3 (discussing how the attorney-client privilege is narrower than the rule of confidentiality which applies not only to matters communicated in confidence by the client but also to all information relating to the representation).
client's ability to place his complete trust in the lawyer-client relationship, and to encourage and facilitate full and candid exchanges of information between the lawyer and the client.\textsuperscript{52}

Rule 1.6 obligates the lawyer to confidentiality even with respect to information concerning the representation that is in the public domain and is readily ascertainable by third parties, or is garnered by the lawyer from sources other than the client.\textsuperscript{53} The prohibition also applies to disclosures that "could reasonably lead to the discovery of [client] information by a third party."\textsuperscript{54}

The Rule and the related comments suggest that the lawyer's use of a "hypothetical" that embraces a client's situation is acceptable if, but only if, there is "no reasonable likelihood that the listener will be able to ascertain the identity of the client or the situation involved."\textsuperscript{55} Forum members who post "hypothetical" (or direct) characterizations of client situations on the Forum's ListServe, in search of research leads or opinions from other Forum members, would be well advised to study Rule 1.6 before framing their postings. So would members who offer answers or suggestions premised upon their own client representation experiences.\textsuperscript{56}

The annotation to Rule 1.6 makes clear that it also prohibits disclosure of information concerning the engagement even if the information itself is not confidential in nature.\textsuperscript{57} This consideration is in contrast to the common law rule\textsuperscript{58} that obligates the lawyer to protect confidential client information against disclosure, but provides that the common law prohibition does not reach "information that is generally known."\textsuperscript{59}

Finally, Rule 1.6 also applies to information arising out of consultations with prospective clients (under Rule 1.18) and past clients (Rule 1.9).\textsuperscript{60}

Despite the broad prohibition against disclosure of information relating to the representation, Rule 1.6 allows for disclosure if implicitly authorized in order to carry out the representation (e.g., in the franchisor context, development and filing of an FDD, or in the franchisee context, in order to carry out a negotiation), or with the informed consent of the client. Informed consent in this context means exactly what it suggests: the lawyer must give the client a full (and probably, if only to protect the lawyer's own interest, written) explanation of the pros

\textsuperscript{52}See, e.g., id. at Rule 1.6 cmt. 2 (explaining how as a result of client-lawyer confidentiality, "[t]he client is thereby encouraged to seek legal assistance and to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter").

\textsuperscript{53}See also Part IV.A., infra.

\textsuperscript{54}Id. at R. 1.6 cmt. 4.

\textsuperscript{55}Id.

\textsuperscript{56}See, e.g., In Re Mandelman, 514 N.W.2d 11 (Wis. 1994).

\textsuperscript{57}Model Rules, supra note 1, at 97.

\textsuperscript{58}See Restatement (Third) of The Law Governing Lawyers § 59 (2000).

\textsuperscript{59}For an example of a lawyer who got into ethical trouble for disclosing public information concerning a client, see In re Anonymous, 654 N.E.2d 1128 (Ind. 1995).

\textsuperscript{60}Model Rules, R. 1.18(b) & 1.9(c)(2).
and cons, and the implications, of making and of withholding a given disclosure of information relating to the representation.\textsuperscript{61}

Rule 1.6(b) lists a series of other exceptions to the comprehensive obligation to protect the confidentiality of such information. Disclosure may be permissible to prevent, mitigate or rectify a crime or fraud committed using the lawyer's services, which is reasonably certain to lead to substantial loss (or injury), and a series of other exceptions probably not directly relevant to most franchise situations.\textsuperscript{62}

The implicit authority to disclose information concerning a representation where necessary to carry out the representation is discussed in \textit{In Re Mandelman},\textsuperscript{63} which held that a lawyer violated Rule 1.6 when he asked other lawyers for help on client matters, and transferred client files, without the client's consent.

C. \textbf{Limiting the Scope of an Engagement}

The potentially enormous complexity and specialization of franchise law translates in practice into cost to the client. The Model Rules would not allow a lawyer who was completely unfamiliar with franchise law to bill the client for the lawyer's learning curve.\textsuperscript{64} Thus, it is not unheard of for clients, and lawyers, to attempt to provide meaningful legal service to the client at a more modest cost by entering into an engagement agreement that limits the scope of the representation. For example, many franchise lawyers have been asked by a prospective franchisee to review a UFOC or FDD to "just point out the highlights," or to "just tell me if they've changed anything." The client does not want the lawyer to provide a written analysis of the FDD and all the related contracts, nor does the client want (at the outset) to engage the lawyer to approach the franchisor to negotiate elements of the franchise offering. May a lawyer accept an engagement of such limited scope? Is it possible ethically to provide advice to a franchisee or prospective franchisee "just on the technical issues?"

Under Rule 1.2, the client is responsible for determining the goals of the engagement,\textsuperscript{65} but this is partially offset by the lawyer's obligation to provide competent advice. Under Rule 1.18, even a prospective client is entitled to rely on the integrity and competence of the lawyer whom he consults, and while no cases have been found in the franchise arena addressing this issue, it is possible that the lawyer might have an ethical obligation even before entering into an engagement with the prospective client to advise the client concerning the potential pitfalls of too-narrowly drawn objectives for the representation.\textsuperscript{66} Rule 1.2(c) plainly authorizes a lawyer to enter into a limited engagement if the limitations are "reasonable," and the client gives

\textsuperscript{61} See \textit{id.} at R. 1.0(e) (defining "informed consent" and "the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct").

\textsuperscript{62} Notably, one exception permits disclosure to the extent "the lawyer reasonably believes necessary to secure legal advice about the lawyer's compliance with [the Model Rules]." \textit{Id.} at R. 1.6(b)(4).

\textsuperscript{63} \textit{Supra} note 56.

\textsuperscript{64} Such a fee would not be "reasonable" under the fee provisions of Model Rule 1.5. \textit{See Model Rules, R. 1.5} ("A lawyer shall not make an agreement for, charge, or collect an unreasonable fee. . . ").

\textsuperscript{65} \textit{Id.} at R. 1.2(a).

\textsuperscript{66} \textit{Id.} at R. 1.2 cmt. 6.
informed consent. The history of this element of the Rule shows that the purpose of Subsection 1.2(c) is in fact to facilitate the provision by lawyers of cheaper, “unbundled,” services for low-income clients.

The lawyer may be encouraged by Comment 5 to Rule 2.1 which assures that the lawyer “ordinarily has no duty to initiate investigation of a client’s affairs” but may nevertheless volunteer advice (which may lie beyond the scope of the agreed representation, or that goes beyond purely “legal” advice) as the lawyer deems prudent.

Comment 3 to Rule 2.1 suggests that more narrowly-drawn engagements, such as to provide “technical advice” only, may be more appropriate for more sophisticated and experienced clients who are better able to look out for their own broader interests or to interpret the lawyer’s advice, but may be less appropriate for less sophisticated clients. This calls for application of a fine judgment by the lawyer. A narrowly-defined “technical review” of an FDD may not be a “reasonable” scope for representation to advise a novice investor exploring her first franchise investment, but perfectly appropriate for a client that is an experienced multi-unit franchisee.

The engagement agreement, therefore, should precisely delineate what the lawyer is undertaking to do for the client in that representation, but the lawyer must give careful consideration to the surrounding circumstances to determine whether the defined scope of the representation is “reasonable.”

IV. GROUP ENTITY CLIENTS

A. Associations and Co-ops

At some point, most franchise lawyers will encounter an entity outside of the mold of a normal business corporation. Entities made up of constituent organizations may appear in the form of a franchisee association, a purchasing or advertising co-op, or an interbrand coalition. These entities are different from groups of individual franchisees in that the entity is a distinct organization, made up of autonomous constituent organizations (other S or C corporations, sole proprietors, non-profit corporations, or other forms of business organization). Indeed, experience suggests that associations, co-ops and similar organizations are increasingly common, and play an increasingly significant role in each franchise network in which they appear. Independent academic research on networked businesses, including franchises, suggests that such organizations play a critical role in the commercial and competitive success of franchise systems.

Naturally, a lawyer engaged by such an entity has noteworthy ethical responsibilities associated with the peculiar character of these organizations. Under Rule 1.13(a), the organization itself (not its members or shareholders) is the client, acting through its duly

67 Comment 6 provides, “A limited representation may be appropriate because the client has limited objectives for the representation.”
68 See Andrew C. Selden, Organization Design for Successful Franchising, 20 Franchise L.J. 1 (Summer 2000).
70 Assuming the engagement agreement has been properly drawn.
authorized constituents. The Rule uses the word “constituent” in this context to refer to the executive officers (or similar officials) of the entity. Comment 13 to Rule 1.13 states that where the client organization is a trade association, the “constituents” do not include the rank and file members, although individual members of a trade association under the right circumstances can become an inadvertent client of the association’s lawyer. This distinction is especially important for franchise counsel dealing with a franchisee association, or cooperative, because the lawyer should expect that in his dealings with the individual members of the association or cooperative, absent a separate lawyer-client relationship with the member, communications may not be privileged, and great care must be taken not to disclose client information relating to the representation in violation of Rule 1.6.

An ABA ethics opinion\(^7^1\) addresses the circumstances in which an individual member of an association may become a client of the association’s lawyer, based on the totality of the facts and circumstances. Although any test framed in terms of the “totality of facts and circumstances” is not helpful in terms of drawing bright line distinctions, the Opinion does illustrate the risks to the lawyer who does not clearly delineate his role, in the course of dealing with association members. The Opinion focuses its analysis on the character of information disclosed by the member to the lawyer, and the members’ expectations arising out of their interactions with the lawyer. If the lawyer allows the member to believe that the communication of information is confidential, and that the lawyer will be attending to the individual legal needs or interests of the member, a lawyer-client relationship may be created, however inadvertently.\(^7^2\) The Opinion explores whether the disclosure of information by the member to the lawyer did or could prejudice the interests of the member, or result in impairment of the duty of loyalty of the lawyer.

Whether members of a trade association might inadvertently become clients of the association’s lawyer may depend upon whether the member’s disclosure of information to the lawyer (in the course of the lawyer’s work on behalf of the association) did or might prejudice the interests of the member, or impair the lawyer’s duty of loyalty to the client. In Westinghouse Electric Corp. v. Kerr-McGee Corp.,\(^7^3\) for example, an association of manufacturers engaged counsel to compile a report for use in Congressional lobbying. The firm collected and compiled confidential commercial information from association members, on the strength of representations to the members that their individual information would not be reported in a traceable, identifiable fashion. Later, a different office of the same law firm, in a different city, accepted an engagement to represent a plaintiff in litigation against some overlapping members of the association on the same general subject matter as in the report. The Seventh Circuit opinion (ruling on a motion to disqualify) notes that while the lawyer-client relationship is fundamentally an agency relationship, that does not mean that it can arise only through the express or implied consent of both parties. It also does not depend on who pays the lawyer for the lawyer’s services.\(^7^4\) The Seventh Circuit noted that a lawyer’s duties can extend beyond an express lawyer-client relationship to others. On the facts presented, the Seventh Circuit held


\(^7^2\) This situation also may arise in a corporate setting. In Manion v. Nagin, 394 F.3d 1062 (8th Cir. 2005), the Eighth Circuit considered the corporation’s executive director a client of the entity’s lawyer, after the lawyer gave advice to him regarding his employment agreement.

\(^7^3\) 580 F.2d 1311, 1317 (7th Cir. 1978).

\(^7^4\) See Model Rules, R. 5.4(c) ("A lawyer shall not permit a person who... pays the lawyer to render legal services for another to direct or regulate the lawyer’s professional judgment in rendering such legal services.").
that the members of the association who contributed information to the report reasonably believed that the law firm was acting in their interests and on their behalf. The firm, therefore, was disqualified from its litigation engagement.\footnote{Westinghouse Elec. Corp., 580 F.2d at 1317.}

The lawyer for a franchisee association in his dealings with member franchisees, can also learn, if only by analogy, from applications of ethical rules to situations in which lawyers are engaged by labor organizations, and in the course of their work for the union, also interact with, or perhaps explicitly represent, individual union members. In a New York State ethics opinion,\footnote{N.Y. State Ethics Op. 743 (2001).} for example, the New York ethics rules were held to provide that if a union’s lawyer is also counsel for a member of the labor organization, then the member’s information imparted to the lawyer must remain confidential \textit{vis-à-vis} the member, under the New York counterpart to Model Rule 1.6, and ordinarily cannot be shared with the union, or with other members. If, however, the member is not a client of the lawyer, then, according to the Opinion, the member’s information ordinarily is not confidential or privileged as between the member and the lawyer, and indeed can and must be shared with the union, and may be shared with other members. The Opinion draws an analogy for this purpose to a lawyer paid by an insurance company to represent the insurer’s insured. The insured is the lawyer’s client, even if the insurance company pays the lawyer’s fees.

In circumstances where the association’s lawyer wishes to avoid having an inadvertent client relationship with a member of the association, under the New York Opinion,\footnote{Supra note 76.} the lawyer must affirmatively dispel the member’s apprehension that he is or might be a client, and must warn the member that information exchanged with the lawyer is not confidential.

In a District of Columbia opinion,\footnote{District of Columbia Ethics Op. 305 (2001).} the District’s ethics committee ruled that under Rule 1.13, Comment 8, a trade association lawyer could ethically represent the trade association in a matter adverse to a member. In a similar situation, the Oregon ethics committee also permitted a trade association’s lawyer to represent one member against another member in a matter unrelated to the lawyer’s representation of the association.\footnote{Ore. Ethics Op. 2005-27 (2005); see also Shadow Isle, Inc. v. Am. Angus Ass’n, No. 84 – 6126 – CV – SJ – 6, 1987 W.L. 17337, at *4 (W.D. Mo. Sept. 22, 1987) (court refused to bar lawyer from representing trade association in suit brought by an association member).} In the lawyer’s dealing with members where that situation may arise, however, the lawyer has an affirmative duty to advise the member of that possibility.

In circumstances where adversity in the franchise system is brewing, the association or co-op’s lawyer must be especially diligent to keep his client, the entity, properly advised as to the character of communications among members, and between members and the executives of the entity. Under Rule 1.13, Comment 3, information obtained from a non-client member of an association by the association’s lawyer may be privileged, but the trade association, not the member, holds the privilege. Discussions among members ordinarily are not privileged unless made in the presence of counsel and for purposes of seeking legal advice.\footnote{In re Arthur Treacher’s Franchise Litigation, 92 F.R.D. 429, 486 (E.D. Pa. 1981).} Rule 1.6
confidentiality, and lawyer-client privilege, also will not attach to discussions between the lawyer and his client, the executives or board of the association, to the extent that the subject matter of the discussion is outside of narrowly-defined “legal” issues.\(^{81}\) This, too, is not a bright line, but both the duty of confidentiality, and the protection of privilege, probably attach to discussions between the lawyer and his client concerning the “legal overtones of the various business strategies” under consideration by the association.\(^{82}\)

B. Interbrand Coalitions

Both franchisors, and franchisee associations or cooperatives, occasionally may find themselves engaged in some variety of interbrand coalition. This may arise in a lobbying campaign on a matter that affects an industry sector, it may involve a cooperative that serves more than one franchise system, or any other variety of organized interaction between or among members of different franchise systems. A lawyer representing a participant in such an interbrand coalition is on thinner ethical ice here even than in the case of an association client. Of course, the lawyer cannot allow his services to be used in connection with illegal conduct by his client (most likely in this context, any type of restraint of trade that violates either federal antitrust laws, or state unfair trade practices laws).\(^{83}\)

Interbrand coalitions also expose the lawyer directly to concerns under Model Rule 1.7 concerning the lawyer’s duty of loyalty to the client. For example, Rule 1.7(a)(2) prohibits a lawyer from accepting an engagement where a significant risk exists that the representation will be materially limited by the lawyer’s responsibilities to another client, or by a personal interest of the lawyer. Such a concern would be especially acute in any kind of political or lobbying engagement involving multiple clients. Where the subject of the lobbying is content-neutral relative to the interests of the participating entities (e.g., minimum wage legislation), the duty of loyalty is not likely to become an issue. Where, however, the subject of the political activity is likely to have a highly differentiated impact on different clients (e.g., various types of commercial regulation which might competitively disadvantage certain categories of businesses, or franchise practices regulations, or even presale disclosure requirements), any outcome, including no change in the state of the law, could easily prejudice the interests of one category of competitor, and benefit another. These outcomes directly implicate Rule 1.7 and the lawyer’s duty of loyalty.

Fortunately, Comment 6 to Rule 1.7 makes clear that mere conflicting economic interests of different clients are not, per se, an ethical conflict. Thus, there is nothing inherently unethical in the mere fact of a lawyer representing two different clients who happen to be commercial competitors. Still, the lawyer in these circumstances must be aware of the competitive environment, and aware of each client’s expectations and values, in order to assess whether representation of a competitor of one client might bring either of the clients to question the lawyer’s loyalty, or the vigor of his representation of their individual interests. Protection of confidential information arising out of such representation of commercial competitors might be especially challenging. In such circumstances, it is possible, on the particular facts and circumstances, that a neutral (e.g., an ethics committee or judge) could conclude that the

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\(^{81}\) Id. at 486.

\(^{82}\) See United States v. Int’l Bus. Machs. Corp., 66 F.R.D. 206, 212-13 (S.D.N.Y. 1974) (discussing how or when an attorney predominantly provides non-legal advice, the advice is no longer protected by the attorney-client privilege).

\(^{83}\) Model Rules, R. 1.2(d).
lender’s representation of one client, and the attendant duty of loyalty or confidentiality, had become materially limited or compromised in reference to the second client.

C. Third Party Communications

A franchise lawyer often communicates with other members of the franchise system who are not the lawyer’s clients but whom the lawyer knows to be represented by counsel. A franchisor’s general counsel regularly communicates with franchisees in a variety of contexts; some of these franchisees may be officers of an association or of a co-op which the general counsel knows to be represented by counsel. A franchisee’s lawyer may find himself emailing a franchisor executive on a routine transaction. Or, an association lawyer may communicate with member franchisees who the lawyer knows are represented. These communications may occur informally or in circumstances involving no hostilities.

A special and particularized set of rules applies to a lawyer’s communication with persons other than the lawyer’s client whom the lawyer knows to be represented by counsel. Model Rule 4.2 prohibits communication by a lawyer with a party whom the lawyer knows to be represented in a matter. A “matter” is not just a litigation. A “matter” exists either when a lawsuit is commenced or when an adversarial relationship exists. Cases interpreting Model Rule 4.2 suggest that a lawyer conducting what amounts to “Rule 11” due diligence for a potential lawsuit may conduct a customary investigation of a client’s claims, including interviewing persons connected with a potentially adverse party, in circumstances that do not involve invading privileged communications, without violating Rule 4.2.84

Comment 4 to Rule 4.2 clarifies that the Rule does not apply to communications “concerning matters outside the representation,” but also makes clear that the lawyer cannot communicate indirectly (through another, including his client) in circumstances where direct communication with a represented party would be prohibited.85

The annotation to Model Rule 4.2 states that the prohibition of Rule 4.2 does not apply to a lawyer advising a client who is seeking a “second opinion” in circumstances where it is plain that the client has consulted another lawyer in the same matter.

Under these principles, both inside and outside lawyers for a franchisor face interesting ethical challenges in dealings with franchisees. Under the holding in Allen v. Int'l Truck & Engine,86 if the lawyer knows that a franchisee is represented by counsel in connection with a “matter” (e.g. enforcement of a franchise agreement in a particular set of circumstances), the

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84 But see Gifford v. Target Corp., Civ. No. 10-1194 ADM/RLE 2010 WL 2771896, at *5 (D. Minn. July 13, 2010) (lawyer disqualified where she interviewed and accepted representation of low-level executive of company the lawyer was considering suing on behalf of other clients, even after taking pro forma steps to avoid receiving lawyer-client privileged information from the executive, because Rule 4.2 prohibits a lawyer from using “methods of obtaining evidence that violate the legal rights of [a third party]” and the lawyer’s interviews were likely to elicit, even inadvertently, confidential and privileged information.

85 For examples of cases where lawyers violated Rule 4.2, see Allen v. Int'l Truck & Engine Corp. 358 F.3d 469 (7th Cir. 2004) (inside and outside counsel controlled private investigators who had contacted adverse parties known to be represented by counsel); and ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 396 (1995) (ld.). In Virginia Ethics Opinion 1820 (2006) a railroad’s lawyer was prohibited from contacting railroad employees whom the lawyer knew were represented by counsel in connection with pending claims against the railroad, even to offer retraining and disability support.

86 Supra note 85.
franchisor’s lawyer is prohibited from communicating, directly or indirectly, with the franchisee. Under the applicable ethics considerations described above, the franchisor’s lawyer also could not participate in directing employed or contracted investigators to communicate with the franchisee on the subject of the enforcement. This could extend to follow up inspections, retraining or remedial actions, or settlement offers. All such communications would have to be directed through the franchisee’s attorney, unless the franchisee’s attorney consented to direct communications. The same principles could prohibit counsel for a franchisor from participating, directly or indirectly, in inspections or enforcement proceedings against a franchisee who was an executive or director of a franchisee association in any manner that was connected to a “matter” between the franchisor and the association.

These ethics considerations can only become more acute, not less, when the general counsel also holds an executive title and other job functions for the franchisor (e.g., anything from “Secretary” to “Vice President-Franchise Relations” to “Chief Franchise Policy Officer”). In these cases, the boundary between the general counsel’s roles as lawyer and as business executive will not always be a bright line, and one suspects that a state bar ethics board, or a judge, would be likely to take a very dim view of conduct by the lawyer that would transgress ethical rules if committed by a lawyer but are being carried out in the guise of “business executive.”

Another common franchise-related communications issue is addressed in an ABA Formal Opinion which concludes that a lawyer may communicate with in-house counsel, even if the corporate employer has hired outside counsel to represent it in connection with a matter. This would apply in a franchise context, for example, in circumstances where a franchisor hires outside counsel to represent it in connection with litigation with a franchisee or franchisee association, and the outside counsel directs counsel for the franchisee or association to communicate only with the outside counsel. Under the opinion, the association or franchisee lawyer is free to disregard that direction, and communicate directly with inside counsel of the franchisor.

V. THE UNAUTHORIZED PRACTICE OF LAW

A. By Consultants

Fortunately, in the franchising context, the question of what constitutes the unauthorized practice of law has only arisen in one context: whether a non-lawyer franchise consultant is

87 See Midwest Motor Sports v. Arctic Cat Sales, Inc., Bus. Franchise Guide ¶ 12,682 (8th Cir. Oct. 20, 2003) (sanctions upheld against lawyers who used private investigator wired to record conversations to pose as a customer to gather information from dealers who were adverse parties to the lawyers’ client, for violation of Rule 8.4’s prohibition against “conduct involving dishonesty, fraud, deceit or misrepresentation.” Id. at 37,225 (internal quotations omitted)).

88 See United States v. Int’l Bus. Machs. Corp., 66 F.R.D. 206, 212-13 (S.D.N.Y. 1974) (when a lawyer provides predominantly non-legal advice, the advice is not protected by the attorney-client communication privilege); see also Reich v. Hercules, Inc., 857 F. Supp. 367, 373 (D.N.J. 1994) (to establish privilege, claimant must show that the corporate lawyer’s communication would not have been made “but for” the claimant’s need for legal advice); Steven M. Goldman and Mary L. Smith, Professional and Ethics Issues: The Attorney-Client Privilege, 23rd Annual Forum on Franchising, Vol. 2 Tab W5, at 5 (ABA 2000) (noting the proposition that a court may apply a higher standard for an assertion of privilege by in-house counsel “because of the potential for an in-house attorney to participate in business decisions and thereby assert the privilege.”).

practicing law when he prepares disclosure documents, franchise agreements and other collateral contracts, and while the issue has not been definitively resolved, in our view the writing is on the wall.

The only reported decision on this subject of which we are aware is Francorp, Inc. v. Siebert. In Siebert, the former president of Francorp was sued by his former employer, Francorp. Francorp alleged, among other things, that Siebert's beginning a similar consulting service violated his post-term obligations to Francorp, and this and most of Francorp's other claims were dismissed upon summary judgment. But, by way of counterclaim, the defendant Siebert argued that his former employer was engaged in the unlicensed practice of law when its in-house attorneys prepared disclosure and other franchise documents allegedly for its clients, and that such conduct violated the Illinois Uniform Deceptive Practices Act. Under Illinois law, an in-house attorney can prepare contracts for the client by whom he or she is employed, but cannot do so for the employer's customers or clients unless the lawyer is licensed to practice law in that jurisdiction. Siebert's theory was that even though Francorp claimed that the documents were for the benefit of Francorp, in fact they were prepared for the benefit of Francorp's clients. Thus, the conduct constituted the unauthorized practice of law. The issue was of importance to Siebert because he believed himself to be at a competitive disadvantage since he did not engage in the preparation of these kinds of documents.

In responding to Siebert's motion for summary judgment, the court ultimately refused to rule in Siebert's favor, noting that issues of fact needed to be addressed; in particular, the court felt that it was ambiguous as to where the responsibilities resided under the Francorp business model. However, noteworthy in this decision was the court's recognition of what constituted the "practice of law." The court said,

One who drafts franchising agreements must exercise judgment with respect to franchise, trademark and contract law, among others, to ensure that the document produces the desired results and guards against undesired ones. . . . Drafting franchise agreements, offering circulars and license agreements, and executing registration certificates is practicing law.

Despite Siebert, the propriety of non-lawyer franchise consultants drafting franchise documents was a relatively dormant issue until this year. Recently, in Jitterswing, Inc. v. Francorp, Inc., Francorp is again accused of the unauthorized practice of law, but in this case for different reasons. Francorp had entered into a consulting agreement with Jitterswing, a Missouri franchisor, with the specified services being performed in large measure at Francorp's headquarters in Illinois. The contract specified that Illinois law would be controlling, and Illinois the exclusive jurisdiction, with respect to claims made "under this Agreement." Suit was brought by Jitterswing in Missouri, and the trial court ruled that an Illinois court would be the proper forum for resolving the dispute. On appeal, however, the Missouri Court of Appeals reversed. The appellate court reasoned that the unauthorized practice of law was a claim in tort, not in contract, and thus was not a dispute "under [the consulting] agreement." The appellate court also noted that since the claim was based on the application of a Missouri statute, an Illinois court might likely duck the issue, thus leaving the plaintiff franchisor without a remedy. The

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90 211 F. Supp. 2d 1051 (N.D. Ill. 2002).

91 Id. at 1057.

court did not specifically address the substance of the unauthorized practice of law claim, but, if the case does not settle, that issue will be before the court in the months to come.

The subject of what non-lawyer consultants can and cannot do has been addressed in the franchise literature. At the 2007 30th Annual Forum on Franchising, Michael Seid, a franchise consultant, and Leonard Vines, a practicing attorney, addressed this topic in their paper entitled, The Respective Roles of the Franchise Consultant and the Franchise Lawyer in Structuring the Franchise System. They heavily emphasize the fact that the boundaries between legal advice and business advice are typically very blurred, although drafting documents is one point where there seemed to be no difference in opinion between the two: It constitutes the practice of law.

The subject of the unauthorized practice of law by non-lawyer franchise consultants was also addressed in point/counterpoint articles published in LJN's Franchising Business and Law Alert written by author Barkoff and Michael Seid. Author Barkoff came to the conclusion that document drafting did constitute the practice of law and intimated that other conduct might fall within the parameters of work from which a non-lawyer franchise consultant should refrain. Author Seid again noted that business advice and legal advice frequently intersect, making it all-the-more difficult to identify what does and does not constitute the practice of law.

Thus, there are several questions on this subject left open today, including:

- Will other courts adopt the definition of “practice of law” adopted by the Siebert court?
- Will consultants abandon the practice of drafting franchise documents?
- What ethical questions are raised for a lawyer when a franchisor is told by the consultant, “Here are the documents; now have your lawyer look them over?” Can the lawyer ethically do only a “quick and dirty” review? Can the franchisor and his lawyer agree to limit the scope of review to that degree? In so doing, is the lawyer setting himself up on an ethical claim later because he has not competently represented his client in the transaction? And under these circumstances, is the lawyer aiding in the unauthorized practice of law – itself a violation of Model Rule 5.5(a)?
- Will the courts go so far as to sanction the consultant (and in the Jitterswing case, the attorneys employed at Francorp) when much of the service was performed in a state by duly authorized attorneys in that state, but the client resided in a different jurisdiction?


96 “A lawyer shall not practice law in a jurisdiction in violation of the regulation of the legal profession in that jurisdiction, or assist another in so doing.” Model Rules, R. 5.5(a).
It is surprising, given the trend in this area, that all franchise consultants have not abandoned the practice of drafting franchise documents. Those who have not are walking a dangerous tightrope.

**B. The Problem of Interstate Practice**

This last bullet point of the previous section leads directly into a related topic: Can a lawyer located and licensed in state X represent a client in state Y? The issue can arise either in an adversarial (litigation or arbitration) context, or in a transactional context.

This subject was addressed in detail at the 2008 Annual Forum on Franchising by John Baer and author Barkoff.\(^{97}\) In the litigation context, the answer is probably yes, because the court procedures relating to *pro hac vice*\(^{98}\) give litigators a "get out of jail free" card. In addition, they can usually hire local counsel (who frequently serve as little more than mail drops), and use that to justify their prosecution or defense of a proceeding in a jurisdiction where they are not otherwise licensed to appear before the court.

The problem is not so simple for transactional lawyers. We would conclude that the answer must be "yes" because the wheels of commerce in franchise representation would almost grind to a halt if the answer were no. We would bet that every transactional attorney who attends this program or reads this paper would under oath have to testify that he or she at some time has represented an out-of-state franchisor or franchisee in establishing, buying or selling a franchise which would be operated in another jurisdiction or by a resident of another jurisdiction.

Are we all going to be sanctioned collectively? Will some state bar official take aim at a particular lawyer and make him or her the guinea pig? If the attempt to limit practice geographically is successful, what would this mean to franchise clients, besides higher costs for legal representation? And what would be the implications to other areas of practice where legal representations are routinely interstate in nature?

There are also equitable considerations. Many of the attendees at this workshop spend a considerable amount of time keeping abreast of developments in jurisdictions where they are not physically located. Would the client be better represented by (1) a skilled, knowledgeable attorney from another jurisdiction representing him, where that person has taken the necessary steps to learn the law of that foreign jurisdiction, or (2) a person who just passed the bar, and is now licensed to practice in that jurisdiction, but has had no practical exposure to the art of practicing franchise law?

The Model Rules give some, but only superficial, answers to these questions. Model Rule 5.5 provides in part:

\[(c)\] A lawyer admitted in another United States jurisdiction, and not disbarred or suspended from practice in any jurisdiction, may provide legal services on a temporary basis in this jurisdiction that:

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\(^{97}\) John R. F. Baer and Rupert M. Barkoff, *Ethics Issues in a Multijurisdictional Franchise Practice*, 31st Annual Form on Franchising 1, Vol. 2 Tab W17 (ABA 2008).

\(^{98}\) A procedure that permits attorneys to appear in courts located in jurisdictions where they are not licensed to practice law, for the limited purpose of representing their clients in the proceeding before the court.
(4) [A]rise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice.\textsuperscript{99}

The Commentary to the Rule 5.5 is also helpful, but not necessarily dispositive, of the issue. Comment 14 provides:

A variety of factors evidence such a relationship. The lawyer's client may have been previously represented by the lawyer, or may be resident in or have substantial contacts with the jurisdiction in which the lawyer is admitted. The matter, although involving other jurisdictions, may have a significant connection with that jurisdiction. In other cases, significant aspects of the lawyer's work might be conducted in that jurisdiction or a significant aspect of the matter may involve the law of that jurisdiction. The necessary relationship might arise when the client's activities or the legal issues involve multiple jurisdictions, such as when the officers of a multinational corporation survey potential business sites and seek the services of their lawyer in assessing the relative merits of each. In addition, the services may draw on the lawyer's recognized expertise developed through the regular practice of law on behalf of clients in matters involving a particular body of federal, nationally-uniform, foreign, or international law. (Emphasis added.)\textsuperscript{100}

Hopefully, if the issue must be addressed judicially, the court will take an enlightened view focusing on the needs and expressed preference of the client. Otherwise, many of us might find ourselves with more work than we can handle, as deals become overly-lawyered to address the problem of their multi-state nature, or, alternatively, with no clients because they will conclude that the benefits from franchising do not justify the transactional costs.

The application of Rule 5.5 and Comment 14 to a typical franchising situation remains unclear, even using the Comment 14 factors to guide the analysis. Question include:

- Can a lawyer licensed in state A file a franchise registration application in state B? Does it matter where the client is headquartered, or incorporated?
- Can a lawyer licensed in state A accept a representation request (assume unsolicited) from a franchisee located in state B? If so, can the lawyer visit the client in state B and offer legal advice during the visit?
- Can a lawyer licensed in state A represent a franchisor in a negotiation conducted in-person in state B?

\textbf{VII. CONCLUSION}

We are truly in the new millennium when it comes to the role and potential liability exposure of the franchise lawyer in the franchise community. First, lawyers clearly owe a duty of competence to the client, but it is not at all clear exactly what "competence" entails for various franchise engagements, or how far, if at all, the duty goes beyond the client. Second, non-lawyers helping franchisors sell franchises may be navigating in poorly charted waters if they try

\textsuperscript{99} Model Rules, R. 5.5.

\textsuperscript{100} Model Rules, R. 5.5 cmt. 14.
to give clients "the Full Monty" – that is, if they provide one-stop shopping for franchisors in the
development of their franchise systems.

The Model Rules were not written with the complexities of franchise practice in mind. Like most traditional "legal" concepts, their motivating premise appears to have been largely adversarial, and two-party, in character, rather than relational and multi-party or network business-based. Still, the fundamental ethical precepts are fully applicable to franchise lawyers, even if one has to think creatively about how to apply them. Duties of competence, loyalty, diligence and confidentiality are foundation stones of a successful franchise lawyer's practice, but they can also be traps for the imprudent or inattentive lawyer. And, "the law," in the form of a body of developed cases and formal ethics opinions applying ethical principles in the specific realm of franchise practice, remains to be written.

Whatever the right conclusions or predictions may be, we urge you to pay more attention to these issues in the upcoming years, for many of them may fall far closer to home than you realize.
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Mr. Barkoff served three years as Chair of the American Bar Association’s Forum on Franchising and served six additional years on its Governing Committee. He is Co-Editor-in-Chief and a contributing author of the Forum’s *Fundamentals of Franchising* and has written over 200 published pieces on franchise law. He serves as a columnist on franchise law for the *New York Law Journal* and for *Franchise UPDATE* magazine. He has also served as a member of the advisory committee to the North American Securities Administrators Association’s Franchise and Business Opportunities Project Group, and has testified before the U.S. House of Representatives Small Business Committee on franchise issues.
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Mr. Selden was the Reporter of the Uniform Franchise and Business Opportunities Act promulgated by the National Conference of Commissioners on Uniform State Laws, and is a member, and former Chairman (1983-87), of the Industry Advisory Committee to the North American Securities Administrators Association's Franchise and Business Opportunities Project Group. Mr. Selden was an accredited delegate of the International Bar Association to the UNIDROIT conference on a model international franchise law.

Mr. Selden is Co-Editor-in-Chief and a contributing author of the Forum's Fundamentals of Franchising. He has published articles on franchising and other topics in the Franchise Law Journal, The Wall Street Journal, The Business Lawyer, the IFA Franchise Legal Digest, and other publications, and has spoken at numerous programs on franchising and antitrust issues sponsored by the Forum on Franchising; Bond University, Queensland, Australia; International Franchise Association; Practicing Law Institute; Minnesota (and other states') continuing legal education; and, the ABA Sections on Antitrust Law, and Patent, Trademark and Copyright Law. Mr. Selden was Chairman (1994-96) and is a member of the Board of Directors of the Better Business Bureau of Minnesota, Inc. He is listed in The Best Lawyers in America, published by Woodward/White, and has been selected as a "Leading Minnesota Attorney." Mr. Selden's law practice involves representation of regional, national and international franchisors, national and global franchisee associations, and franchise system purchasing cooperatives.