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AFA Blast Fax!

Representing the interests of small business franchisees nationally.

American Franchisee Association
53 West Jackson Boulevard, Suite 205
Chicago, Illinois 60604
312-431-0545

www.franchisee.org

The Staff and Board of Directors of the American Franchisee Association (AFA) extend best wishes to you for a safe, happy and healthy holiday season.

Take Litigation Disclosure in UFOC with the Proverbial "Grain of Salt"

Consider this scenario; a franchise case settles in the midst of trial. As part of a confidential settlement agreement, the franchisor buys out the franchise rights of the franchisee at a significant premium in excess of fair market value. In exchange, the franchisee agrees to concede liability. In other words, the franchisor buys the right to publicly declare "victory." Victory is extremely important to franchisors since the biggest concern expressed by franchisors in the disposition of any litigation with franchisees is the risk of an adverse precedent leading to the stereotypic "opening of the floodgates" of litigation against the franchisor. Thus, the need to declare victory by the franchisor is of the utmost importance in any franchise dispute.

Such a settlement structure allows the franchisee to realize a significant premium over the fair market value for his or her franchise rights and also allows the franchisor to declare victory in communications throughout the franchise system. Presumably, such communications will serve to discourage other franchisees from fighting a similar "losing" battle against the franchisor.

The American Franchisee Association is pleased to bring you a training program like no other— "The Interactive Business Building Series." For more information see page 2 of this Blast Fax to access information on this exciting program.

But is this really a clear "win-win" for both sides? Indeed, confidential settlement agreements are often structured in this manner in franchise litigation. However, does this negotiated settlement result in misleading information being published by the franchisor in the Uniform Franchise Offering Circular ("UFOC") about the disposition of such litigation?

The Federal Trade Commission's (FTC) Franchise Rule (16 C.F.R. §436.1(a)) broadly requires a franchisor to provide prospective franchisees with several categories of "information, accurately, clearly, and concisely stated," including "[a] statement disclosing" any litigation "which was brought by a present or former franchisee or franchisees and which involves or involved the franchise relationship..." 16 C.F. R. § 436.1(a)(4)(ii) [emphasis added]. The FTC's Franchise Rule allows franchisors great latitude in describing their litigation experience in the UFOC. As you can imagine, franchisors can be expected to put their best "spin" on their litigation experience with franchisees.

Most importantly, the franchisor in the hypothetical settlement discussed above will disclose its "victory" over the franchisee in its UFOC. Are readers of UFOCs--primarily prospective or renewing franchisees--misled by these manipulated results? Franchisors will argue that there is nothing manipulated or misleading about these disclosures. The accurate disposition of the case, reached through negotiation and settlement, is properly reported in the UFOC according to the franchisor. According to the franchisor, the settling franchisee should not care since the franchisee achieved the result he or she was seeking and is no longer in the franchise system.

A prospective or renewing franchisee should pay particular attention to the litigation section of the UFOC, since litigation is the last place anyone wants to end up. However, readers of UFOC litigation disclosures must understand that the information contained in the UFOC regarding the disposition of litigation may be technically accurate, but often does not tell the whole story.

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The prospective or renewing franchisee must, therefore, dig deeper than the description of the litigation in the disclosure and ask him or herself what led to the litigation between the franchisor and the franchisee contained in the UFOC and, most importantly, how it could be avoided. The prospective franchisee should attempt to contact some of the franchisees involved in litigation with the franchisor to determine whether the information contained in the UFOC accurately describes the case. Was it the franchisee's own fault that the litigation took place? Or did the franchisor commit some type of wrong against the franchisee?

These are the questions that should be fully investigated by a prospective franchisee in conducting his or her due diligence. By gaining an understanding of the prior litigation experience of the franchisor, a prospective franchisee can learn how he or she can avoid such litigation in the future, and can also determine whether the franchisor was justified and acted reasonably in its prior disputes with franchisees. Obviously, if a franchisor is overly litigious and unreasonable with its franchisees, the prospective or renewing franchisee can expect the same treatment.

In short, prospective and renewing franchisees must not merely rely on the disclosure information drafted by the franchisor regarding prior litigation as part of their due diligence since such disclosures may not tell the whole story. Rather, direct contact with the franchisees involved in the litigation is imperative in order to gain a complete and accurate understanding of the nature of all prior litigation.

This article was written by Robert Zarco, Esq. founding partner of the Miami, Florida law firm of Zarco & Pardo, P.A. and Robert M. Einhorn, Esq. managing partner of the firm. Contact Messrs. Zarco and Einhorn at 305-374-5418.

Franchisee Satisfaction Survey

Let others know how you feel about your franchising experience. Take part in the annual Franchisee Satisfaction Survey conducted by the School of Business at Indiana University Southeast. The survey instrument was designed by franchisees cooperating with academic researchers to measure satisfaction with a franchise system.

Complete the survey at
http://homepages.ius.edu/FWADSWO/privacy_consent.htm. If you have any questions about the survey contact Frank H. Wadsworth, Ph.D., Professor of Marketing, telephone: 812-941-2531; fax: 812-941-2672; or e-mail Dr. Wadsworth at fwadswo@ius.edu.

AFA President Susan P. Kezios recently visited Michael Einbinder, Esq. at the law offices of Rosen, Einbinder & Dunn. P.C. in New York City.

AFA Launches "The Interactive Business-Building Series" in 2002

Every business is feeling the impact of our uncertain economy right now—franchisees included. In these times, it is the smarter, better marketers who are going to prevail and take the market share that IS available. With this in mind, the AFA is very proud and pleased to bring you the American Franchisee Association's "Interactive Business-Building Series."

The AFA has negotiated to bring something remarkable to you. We've persuaded three powerhouse business growth experts to join forces with us to focus their collective brain-power on franchisees' growth strategies. The AFA has even arranged for our members to sample their expertise for free.

This is the program in a nutshell: We've brought together Jay Levinson, author of Guerrilla Marketing (36 books in 25 languages); the world's highest paid business advisor, Jay Abraham ($10,000 per hour if you want to talk to him without our help); and Fortune 500 super strategist, Chet Holmes (this man has had fifty Fortune 500 clients, getting fees of $1 million dollars from a single client). All three will be on the phone, on a teleconference call (attend from anywhere in the world, no travel required), working hand-in-hand with you and franchisees like you to help dramatically boost business.

This is an important program for the AFA and for franchisees in general. We are excited and honored to bring the Interactive Business-Building Series to you. If costs you nothing to check it out and see if you want to participate in 2002. To learn more call 1-888-253-6121, extension WF.

LEGAL BRIEFS

FRANCHISOR FAILS TO DISCLOSE ALL MATERIAL FACTS

Worthy Corporation of Collier County, Inc. and Worthy Corporation of Lee County, Inc. v. The Maids International, Inc., American Arbitration Association Case Number 77 114 00321 00 KLE.

The Claimants/franchisees filed suit against The Maids International, Inc. ("TMI"), a franchisor of household maintenance and cleaning service businesses, alleging that TMI was liable to the Claimants for fraudulent and/or negligent misrepresentation arising out of TMI's misrepresentation of the existence of two previous franchisees that had operated and failed in the Southwest Florida market. Claimants alleged that this same conduct violated the Florida Unfair and Deceptive Trade Practices Act ("FUDTPA") and the Florida Franchise Act.

Specifically, Claimants alleged that in response to a direct question by Claimants prior to the execution of the franchise agreement as to the existence of previous franchisees in the Southwest Florida market, TMI's sales representative specifically denied having any knowledge of any previous franchisees in that area. In reliance upon the misrepresentation made by TMI, Claimants purchased two TMI franchises in Florida, which subsequently failed as a result of, inter alia, the seasonal nature of the market and specific demographic issues which usurped the financial viability of the franchises.

During the arbitration proceeding, Claimants were able to elicit testimony that proved that the sales representative was, indeed, familiar with the previous franchisees, yet failed to disclose the identity of these franchisees to the Claimants. After a three day arbitration hearing, the arbitrator awarded Claimants the sum of Three Hundred Sixty-Two Thousand Seven Hundred Ten Dollars ($362,710.00) on their claims against TMI.

The decision of the arbitrator served to reinforce the notion that a franchisor is required to disclose all material facts necessary to effectuate a franchise sale, especially in response to a direct question from a prospective franchisee.

Alejandro Brito of the law firm of Zarco & Pardo, P.A. in Miami wrote this Legal Brief. Alejandro Brito and Robert Zarco represented the franchisees in this matter. Contact Messrs. Brito and Zarco at 305-374-5418.

FRANCHISOR RESPONSIBLE FOR STATEMENTS MADE BY ITS SALES REPRESENTATIVE

Edward Sheskier, Jr., Diana Dinardo, Sheskidin II, Inc. and Sheskidin Enterprises, Inc. v. Blimpie International, Inc., American Arbitration Association Case Number 13 114 00309 00

The Claimants/franchisees filed suit against Blimpie International, Inc. ("Blimpie"), alleging that Blimpie's sales representative made numerous misrepresentations of material fact relating to, inter alia, the anticipated amount of annual sales, return on investment and profit margin that the Claimants could expect to generate by simultaneously purchasing three Blimpie franchises. Further, Claimants alleged that Blimpie failed to disclose in its UFOC the identity of, and any information relating to (including the criminal history of), the sales representative. Claimants asserted several claims, including claims for fraudulent misrepresentation, violation of the New York Franchise Sales Act, violation of the New York Consumer Protection Act and breach of contract.

Blimpie denied that its sales representative made the subject misrepresentations and that, even if he did make the misrepresentations, Blimpie was not liable for such misrepresentations, because the sales representative was not authorized to make such statements on behalf of Blimpie. Claimants successfully rebutted Blimpie's contention by proving that under New York law, any person materially involved in the sale of a franchise is responsible for a franchise law violation. After a lengthy arbitration proceeding, the three-member arbitrator panel agreed with Claimants' contentions and awarded Claimants the sum of Three Hundred Four Thousand Six Hundred Thirty Three Dollars and Eighty Eight Cents ($304,633.88), as well as a determination that the subject franchise agreements were canceled. The result of this case, in addition to proving to be very satisfying to the Claimants, highlighted the disclosure obligations placed upon a franchisor with respect to its sales representatives under New York law. In addition, the decision confirmed the notion that, despite a franchisor's aptness to disavow the statements made by its sales representatives, it is, indeed, responsible for such the statements, particularly when the statements relate to unfounded earnings claims or other inappropriate subject matters.

Alejandro Brito of the law firm of Zarco & Pardo, P.A. in Miami wrote this Legal Brief. Alejandro Brito and Robert Zarco represented the franchisees in this matter. Contact Messrs. Brito and Zarco at 305-374-5418.