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ou've done your homework and collected a load of information about franchise opportunities. You have offering circulars and promotional brochures, and you've met with sales representatives. You've spent hours sitting in other people's businesses, imagining yourself in their shoes.

But you've also read about the problems franchising is facing—the congressional hearings, the legislative clashes between franchisors and franchisees in state capitols—and you're wondering if now is the time to buy a

franchise. The surprising answer? Now may be a better time than ever.

Growing Pains

Franchising is experiencing the pain of its teenage years—and as with all adolescents, the maturation process is not always easy to watch. The debate in Congress among state legislators, franchisee and franchisor associations, lawyers and the popular press over the regulation of franchising has generated a fair share of horror stories—tales of abusive practices, misrepresentations, inadequate disclosures and earnings claims violations. Whether these hair-raising tales represent mere anecdotal evidence from a few disgruntled indi-

viduals or more deep-rooted problems in the way franchising is conducted has yet to be determined.

It's important that anyone considering buying a franchise be aware of this debate, but it's also important to keep it in perspective. In fact, the outlook on franchise investing is, on the whole, good. While the long-term effects additional regulation will have on franchising are difficult to predict, some early effects of legislative attention are already apparent.

Uncle Sam is giving franchisees a helping hand with new franchising regulations and guidelines.

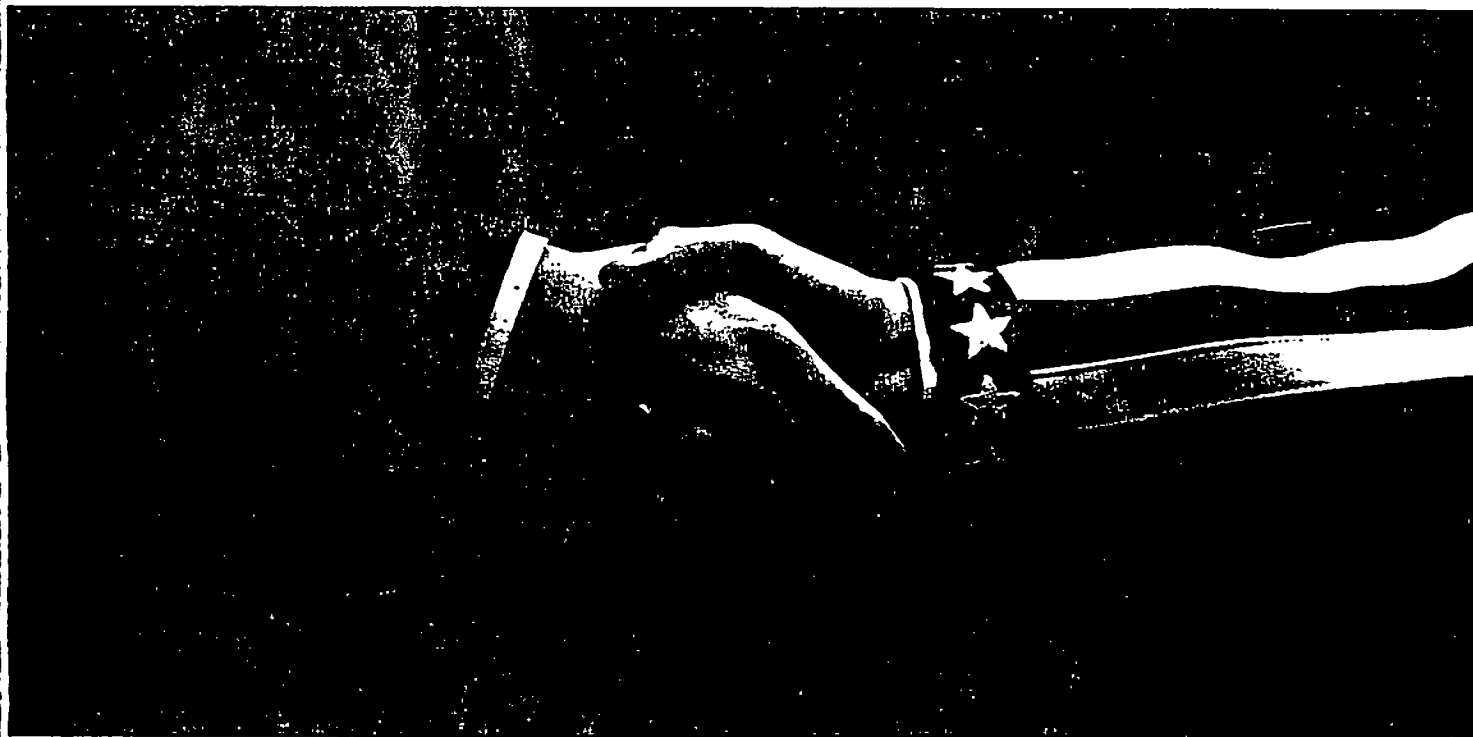


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Law And Order

By Andrew A. Caffey

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Order Out Of Court

Perhaps the most significant change brought about by the turmoil is a re-evaluation of the way franchisors and franchisees resolve their disputes. There is a growing consensus that franchisors should not be so quick to file a lawsuit when struggling with a franchisee relationship issue. Some of the new franchise legislation being introduced mandates using other means of settling disputes, known in the legal profession as Alternate Dispute Resolution (ADR) techniques. These private methods can eliminate the need to take franchise disputes to the public courts, which are slow, overcrowded and extraordinarily expensive.

ADR techniques include a number of time-tested ideas, as well as a number of innovations. In some franchise systems, an *ombudsman* is used. An ombudsman is a person or committee designated by the franchisor to intervene in disputes that arise and determine an informal resolution. The ombudsman is selected in advance as part of the franchise agreement.

Mediation by a neutral party, often a professional mediator or a retired judge, is also growing in popularity. "Mediation is attractive to franchisors and franchisees for a number of reasons," says James F. Smyth, vice president of sales and marketing for Endispute Inc., a Washington, DC-based provider of private dispute resolution services nationwide. "Not only is it nonbinding until both parties agree on the resolution terms, but it is also quick and private. In franchising, that is a significant attraction because mediation is the least damaging to the ongoing business relationship. In the hands of a professional, mediation is the best of the ADR techniques for most disputes we see in franchising."

Mediation has an additional advantage for franchisors: A mediated dispute generally does not have to be disclosed in the Uniform Franchise Offering Circular (UFOC).

Arbitration is a more formal and generally binding process in which the parties present their cases to a selected arbitrator or panel of arbitrators and receive a judgment. "An arbitration provision in a franchise agreement can be used by either party to prevent fighting it out in court," says Smyth.

Another ADR technique involves *minitrials* in which the parties present a short version of their case to a mock jury. The minitrials are not meant to provide legally binding decisions—

What's Happening?

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he franchise community is experiencing an unprecedented surge in legislative attention and public policy debate—changes that promise to revolutionize franchising. Here's a quick summary of recent developments:

Congress: Rep. John LaFalce (D-NY) introduced three bills in the 103rd Congress and conducted a two-year series of subcommittee hearings into franchising's problems.

•H.R. 1315, the Federal Franchise Disclosure and Consumer Protection Act, would create national disclosure requirements that exceed current Federal Trade Commission disclosure rules, and would allow franchisees a private right of action if these are not met.

•H.R. 1316, the Federal Fair Franchise Practices Act, would impose on franchisors a national law dictating rules concerning termination, nonrenewal, transfer approval, encroachment, source-of-supply restrictions, and standards of good faith and fair dealing.

•H.R. 1317, the Franchise Data and Public Information Act, would require franchisors to file their disclosure documents with the Department of Commerce, which would analyze the data and publish reports annually.

Iowa: On July 1, 1992, Iowa's franchise law went into effect, imposing restrictions on transfers of franchised businesses, placement of additional franchises near an existing unit, and franchisors' source-of-supply requirements. Part of this law was deleted in May 1993, when a federal court found the section that retroactively applied the law to existing franchisees to be unconstitutional.

Texas: This year the Texas legislature came extremely close to adopting a bill modeled on parts of the Iowa law.

North American Securities Administrators Association: This group proposed a radical new form of UFOC disclosure document, requiring that documents feature "plain English," tables, charts and forms for easier digestion by prospective investors. —A.A.C.

rather, they allow both sides to air their grievances and set the stage for more effective negotiating. In this vein, some franchise systems use full-blown private court systems.

Review the UFOC and franchise agreement and determine whether it uses these or other ADR techniques. If the answer's not clear, ask your franchisor's representative. You can expect the use of

ADR techniques by franchisors and franchisees to increase exponentially in the next few years.

Can You Say That In English?

Franchisors are also reconsidering the fairness and "readability" of their franchise agreements and UFOC disclosure documents. Franchise agreements are being heavily criticized in the legislative arena for being too long, too one-sided in favor of the franchisor, and intimidating in their complexity. UFOC disclosure documents are often burdened with the same turgid prose as the franchise agreements, and are organized in a convoluted and sometimes irrational structure. They're deemed unreadable by many prospective franchise owners.

The change that would offer the most impact on the franchising industry is a new UFOC format. This would require franchisors to completely recast the structure and language of their disclosure documents. The new UFOC guidelines mandate the use of "plain English" in disclosures, the use of understandable and clearly organized outlines, and the addition of cross-referenced tables and charts for presenting information about the franchise offering. The guidelines, adopted this year by the North American Securities Administrators Association, have not yet been given the OK by the Federal Trade Commission or states that require franchise registration, but this is expected to happen over the next two years. When it does, the face of the franchise sales process will change dramatically.

Protected Territory

The new franchise relationship law that went into effect in Iowa on July 1, 1992, provides a detailed set of rules that apply to the transfer of franchises and the circumstances under which a franchisor may exercise its transfer approval rights. This legislation reaches well beyond the traditional limits of similar state laws on termination and nonrenewal. The Iowa law also contains extensive territorial protection for franchisees, designed to discourage

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franchisors from encroaching on franchisees' markets. Franchisors are prohibited from placing another franchise within an "unreasonable proximity" of an existing franchise.

These new legal protections are radical ideas in the world of franchise regulation. In response to the Iowa legislation, more state legislatures than ever before are entertaining new franchise regulation proposals. Also, franchisee organizations are banding together to lobby for new protections.

However, as attractive as these new regulations may sound to franchisees, celebrating may be premature. A number of commentators are questioning how the Iowa statute, and others that are likely to follow it, will affect franchise relationships. Many franchisors have announced they will no longer offer franchises in Iowa because of the uncertain atmosphere the new legislation created.

Buyer Beware

How do these legislative developments affect you, the potential franchisee? While additional protection

offered to franchisees in some states may have a marginal effect on your decision to purchase, and national standards now being discussed in Congress may alter franchise laws later this decade, the changes made thus far will have relatively little effect on today's purchaser.

Regardless of what legislation is eventually adopted, the fundamentals remain the same: Buyers must take care to purchase a franchise that meets their own needs from a seller with a strong track record of support, service and success. The *politics* of franchising is changing, and along with it the balance of legal power between franchisors and franchisees. But the *business* of franchising remains strong and appears poised to take full advantage of the economy's eventual recovery from the recession.

In fact, during this time of turmoil in the franchise community, quality franchisors will rise even more quickly to the top. These are the companies that addressed the challenges of modern franchising well before the current complaints began echoing in

the halls of Congress. It's easy to recognize these companies in the marketplace: Their programs clearly convey their fair, evenhanded approach to business, their franchisees speak respectfully of the franchisor and its representatives, and that respect is reciprocated.

All franchisors have been affected by the recent debates, and while they are justifiably concerned about new regulation and what it will do to the future of their businesses, the overall effect has been positive. With franchisors becoming more responsive to the concerns of franchisees, you should find that most franchise programs are beginning to tilt in the franchisee's favor, and that the excesses of franchising's past are slowly being eliminated. ■

Andrew A. Caffey is a partner in the Washington, DC, office of Venable, Baetjer, Howard & Civiletti, where he heads a national practice team specializing in the areas of distribution, franchising and business opportunity law.

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