

FRANCHISE LAW INSIDER™

A Publication Reviewing Recent Franchise and Related Business Developments 4th Quarter 2005

"When one helps another, both are strong."
-German Proverb-



HOLMES & LOFSTROM, LLP
Franchise and Business Counsel

IFA QUARTERLY EVENTS
Hosted by
Holmes & Lofstrom, LLP.

January 25, 2006

Topic: Recruiting New Franchisees— Impactful Development

LOCATIONS:

Orange County Breakfast

Scott's Seafood Grill & Bar
3300 Bristol Street
Costa Mesa, CA 92626
7:30 AM

San Diego Lunch

Franchise.com Office
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BUILDING VALUE IS A PROCESS

By: Thomas G. Stevenson, CPA/CVA

The process of building value in a company starts with a basic understanding of how value is determined. Since there is no ready market for closely held stock, an experienced valuator will analyze and examine a vast array of information before selecting an appropriate valuation method. The multitude of valuation methods fall within three general approaches:

- Asset Approach
- Market Approach
- Income Approach

In the Asset Approach, emphasis is placed on the current value of the assets less liabilities. It is typically used for companies with volatile or low earnings, holding companies, companies that will soon be liquidated and capital-intensive operations. It does not provide a value for goodwill, which must be computed separately if it exists.

The Market Approach employs the valuation principle of substitution. The substitution theory states that similar assets have similar values. Therefore, by comparing the company to other comparable companies a reasonable estimation of value is obtained. The Market Approach is a highly regarded method for valuing a going concern because value is derived directly from the marketplace. However, finding suitable comparable companies can be extremely difficult and often time consuming.

For profitable, non-public companies, the Income Approach is usually favored. It measures value based on the principle that the value of a business is equal to the present value of the future benefits of ownership. The benefits of ownership are most often expressed in terms of net cash flow.

The present value factor is usually referred to as a capitalization or discount rate and is generally considered a measurement of investor risk expressed as a percentage.

The Income Approach employs a simple formula to determine value:

$$\text{Value} = \text{Benefit/Risk}$$

Therefore, maximizing value is a function of increasing net cash flow, decreasing risk or a combination of both.

Continued on page 3

IN THIS ISSUE

Building Value is a Process	1
"Talk to the Hand", A System in Trouble	2
"Vendor Partner" Approach to Mystery Shopping.....	3
Franchise Legal Updates	6
Mediation and Arbitration Myths	8

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Firm News!

You may have noticed some new names on our H&L letterhead and website due to some recent changes at our firm.

Steve Wiener Retires.

Congratulations to Steve Wiener on his recent retirement at the end of October 2005! We will miss Steve and his great litigation services to our clients. He is a great friend and we congratulate him on his illustrious legal career. Happy retirement to Steve and Marilyn, enjoy!

John Haraldson Relocates.

John and his wife have recently moved to Kentucky in connection with John's new in-house position at Valvoline. While we are sad to see John leave us, we are pleased that he and his wife have found a home in the region that they have been seeking for some time. Best of luck to the Haraldson's, we will miss you!

Jim Mulcahy New Of Counsel Litigator.

We were most pleased to announce our new of counsel litigation crew! The Mulcahy Law firm is a small "boutique" litigation firm that has joined forces with us to continue to provide outstanding litigation services to H&L clients. Founded by James Mulcahy, the Mulcahy Law firm provides franchise distribution, anti-trust and business litigation services. Along with his team of three associate attorneys, Jim has assumed many of the matters previously handled by Steve Wiener along with a few new cases. We welcome Jim and his firm and foresee continued success from our new affiliation. For more information please visit www.mulcahylaw.com

Liz Lubin- New Administrative Assistant.

Another welcomed addition to our firm gives us more experience and finesse in the administrative services area. Liz Lubin joined us a month ago and we are so please to have her able assistance with events and administration. Christine Goldenberg who was the prior administrator, has left our firm to prepare to enter law school. We wish her well and welcome Liz to our team!

"Talk to the Hand", A System in Trouble

By: Mary Ann O'Connell
O'Connell and Company

"Talk to the hand." It's such an obnoxious phrase, but a great mental image. Can you picture your franchisees with their heads turned away and the palm of their hand in your face blocking out your words? If this mental image is clear and true to you, your franchise organization needs help. If that is how you see your franchisees, it is also the way they see you.

What could cause such a breakdown in communication? What is it costing your company?

The back and forth flow of information from franchisee to franchisor is key to growing a successful franchise network. All components are dependent on open dialogue including the success of the individual franchisees, the quality and speed of validation and the sharing of new ideas to grow and improve the system.

Franchisees need open communication to make them feel a part of the organization. This also helps develop company loyalty. Without this give-and-take in place the relationship will quickly evolve into one that is adversarial.

Let's explore the ways in which franchisors undermine the communication process. They fall into three different syndromes.

"Father Knows Best"

In this case, the entrepreneur who created the concept and the system is running the company. This entrepreneur is proud of the system – and rightly so. But he is probably protective of it too, and therein lays the problem. Believing that he, and only he, knows the best way to implement the system, he doles out the information only as he deems necessary.

Continued on page 4

"Vendor Partner" Approach to Mystery Shopping

By: Leslie Leggate & Troi Lynn Ozburn
National Shopping Service Network,
LLC (NSSN)

Have you ever wondered why people continue to go to the local fast food chain drive-through even though they constantly have to double-check their order before pulling away? Why do consumers pay more for a name brand computer when they can get the same system specifications in a non-name brand priced far less, even though the same company makes them?

Do you know why your customers use your services? What makes your business stand out from your competition? Do people go to your location because it's convenient, because you have outstanding customer service, or do they identify with your brand? What do you need to do to corner a larger share of the market and steadily build your business?

As we have shown in this series of articles for the Franchise Law Insider, competitive mystery shopping programs can help to identify answers to these questions. In order for any business to show longstanding profitability, management must identify and understand what is foremost in the consumer's mind when a decision is made. Mystery shopping your competition and identifying specific reasons as to why customers would or would not return to a location gives you the information you need for business planning and marketing.

As the economy changes and more companies expand into more national and international markets, it is crucial for each geographical area of the company to implement a business plan that provides their customer base the results they expect. There are differences in the way business is done in different markets and clients should

create mystery shopping programs with those differences in mind. Clients need to develop a tailor-made program to address their specific needs in their various geographical and demographical markets.

Depending on a company's goals, mystery shopping can take on many forms. Our clients implement mystery shopping programs for a variety of reasons. Some monitor overall location performance, assess where they stand with their competition, aid in loss prevention, survey exiting customers, determine product compliance, pre-screen applicants, target training and resources, obtain ideas from consumers, monitor franchise or location compliance, or see how well individual employees are performing and the level of customer service they are providing.

Every company can have a cost effective mystery shopping program. We believe that the key is consistency in shopping techniques and frequency, and proper form development. Our experience has shown that generic programs do not provide clients with quality information. While generic programs may cost less, in the end they can be more costly because the information obtained is not as in-depth and can be less accurate. Thus, the client sees fewer benefits from the program.

NSSN approaches these issues by providing strong support to clients as a 'vendor partner'. As the economy changes and business continues to develop and evolve, so too will your need for mystery shopping services and programs. A good program should fully support your programs and allow you to make changes, as necessary, and provide free consultation to you throughout all stages of your program implementation.

In the last two issues of *FRANCHISE LAW INSIDER*, we have discussed developing a mystery shopping program for your business and the importance of choosing a mystery shopping company to work with you in customizing a well-rounded program. When used correctly, mystery

shopping is a highly valuable tool that guides everyone, from corporate level management to the franchisee or employee, in staying united to achieve the same goals, profitability and performance. A solid and well thought out mystery shopping program will play an integral part in business success.

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Want more information about National Shopping Service Network, LLC and developing a customized mystery-shopping program for your company?

Contact:
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Leslie Leggate at (888) 339-1072, or
Leslie@mysteryshopper.net

Building Value continued from page 1

Increasing Cash Flow:

Net cash flow is usually used as the measurement of owner benefit because it is net cash flow that is actually available to pay dividends.

The primary determinant of what a buyer will be willing to pay for a business is the future cash flow that the buyer expects to realize from the business. In fact, the single most important factor in closing a sale is the buyer's belief that future net cash flow will continue to grow, thereby, increasing the value of the business.

To increase cash flow, focus activities on the following cash management and profit maximizing techniques:

- Create a cash flow forecast. In essence, put numbers into your plans.
- Collect accounts receivable fast. Check the industry average for the "normal" collection period and set a goal of beating it. Calculate the increase in cash flow of reducing your collection period by just one day.

Continued on page 5

The problem with this is even though the drip of information is done with care and concern; it does not respect the intelligence and experience the franchisees bring to the business. They resent being treated as an inferior and will close off to all input and soon begin to redesign the concept. They may know that what they are doing is incorrect and not a wise business move, but it returns a sense of power and dignity to them.

"What They Don't Know Won't Hurt Them"

This happens in only two instances. First, when a network is new and the franchisor wants to shield the franchisees from anything that would distract them from growing the business. Second, when there are many complaints (or other issues) and the company wants to keep it quiet. Both instances produce the same results: the information gets out to the franchisees and they resent the deception.

Remember: information is power. As franchisors it is our job to teach our franchisees how to think about their business, not just how to do it. They need all the information they can get to process and come to the right decisions.

As for troubles in the franchise system, no one can keep them a secret. Don't fool yourself: experience shows that it's essentially impossible to keep secrets in a franchise system, especially with potentially serious, negative issues. No matter how badly the lines of communication are jammed normally, when there is trouble everybody talks about it. It's better if you control the "spin" on the information, but be sure that it is out in the open. If not, the franchisees begin to wonder what else you are hiding. What else is wrong? Should I worry about my decision to become a franchisee? All trust is eroded in a flash.

Finally there is the Scarlet O'Hara, I'll Think About That Tomorrow syndrome. This is a result of a growing business that gets away from you. There is so much happening at the home office

that there is no time to keep up the lines of communication. You intend to put out a newsletter, but there is never enough time, the manuals are hopelessly outdated, and so on. The result is that only those franchisees that call in regularly and have the ear of upper management know what is going on. They are perceived as the elite by the rank and file franchisees. A class system develops and trust is again undermined.

As doctors say, "this can be fatal if left untreated." The treatment is easier and less painful than a trip to the doctor's office. It begins by respecting your franchisees. Remember that you chose these people to be part of the system. Then take these nine easy steps and call me in the morning:

- Be open and honest
These are your strategic partners. They, too, are invested in your success. In fact, taken together, the franchisees probably have a greater investment in your system than you do, or they will as your system expands. Tell them what is happening and ask for their input. People are more afraid of what they don't know than of any problem presented to them. Also, based on the principle that "All of us together are a lot smarter than any of us individually," they probably have some pretty valuable ideas and insights.

- Be clear and timely
Don't overload the franchisees with too much information; tell them what they need in a clear and concise manner. Remember, some are getting this information for the first time; do not assume they know its history or how to use it.

If the information requires action, be sure to give the franchisees enough time to react and plan - they are busy doing all the other things we demand of them, and this action needs to be scheduled. If it is seasonal advice, be sure there are sufficient lead-time and also a thorough historical perspective. Be sure to tell them (probably more than once) what action is needed and when.

Make the franchisees comfortable

with the information flow by using a regular schedule for mail, memos and publications. What to us seems like a small pause in the information flow can seem like neglect to someone in need. If the franchisees know when to expect information from you they will be less likely to become resentful or accuse you of indifference.

- Sometimes, just listen and show compassion
Most times, when a franchisee wants to talk, it's not for advice and information; it's to be heard. They have the pressure of running the business and then answering to the family if goals are not being met. Perhaps they can't take the problems to their spouse, so they want an audience with someone who understands the business and can listen well. Do that. Accept that the problem exists and don't make any judgments.

- Offer at least two suggestions
Franchisees often expect "the answer" is something franchisors are hiding from them. We actually know the secret to wild success; we just hide it from them. But that is not the case, so to dispel the notion don't give pat answers. Listen to the circumstances, and offer alternatives. If they have a record of success, encourage them by reminding them of that.

- Be an advisor or "coach"
By the time a franchisee has called for advice they have probably looked in the manuals for some answers. They may have tried what is in the manual, and it didn't work for them, so it does not help for you to quote the book. Instead, be a coach and encourage the franchisee to identify the best answer.

To be a coach ask the franchisee:
What results do you want?
Can you be specific?
What has to happen next in order to get the results?
What about the result is important to you?
What will you do?
When will you do it?

If they haven't looked in the manuals, and the manuals have one or more if

Continued on page 6

- Don't over invest in inventory. Analyze the movement of inventory items; remove the slow moving, cash consuming items. Again, check your industry statistics and calculate the savings of reducing your average inventory days by just one.
- View all disbursements as investments. Challenge expenditures that are not paying dividends.
- Maximize your gross profit percentage.
- Take care of your employees. Consider a well-designed employee incentive plan to improve productivity.
- Minimize taxes. Take the time to understand the basic tax framework that your company operates within, and then consult your tax advisor.
- Invest in technology. If your company is not using the latest and most efficient technology it is losing ground in the market place and value is leaking out.

Decreasing investor risk:

A general rule of thumb is "lower the risk the higher the value."

There are a number of factors commonly considered and measured when evaluating a specific company's investor risk.

Below are some of those factors:

1) Financial Trends

- Stability of historical earnings
- Ratio analysis as an indication of financial health

a) Liquidity Ratios measure the quality and adequacy of current assets to meet current obligations.

- Current ratio
- Quick ratio

b) Leverage & Coverage Ratios provide an indication of a company's vulnerability to business downturns and the ability to service debt.

- Debt to Equity
- Times interest earned

c) Operating Ratios assist in evaluating management's performance.

- Return on assets
- Return on Equity
- Collection period days
- Days in inventory
- Sales turnover
- Expense to sales relationships

d) Z score is an analytical technique used to assess the financial performance of a company. It involves a weighting of five different financial ratios that when computed over a series of years provides a predictive index of a company's financial health. (If you are not familiar with the Z score analysis please contact me and I'll provide you with more information.)

2) Over-reliance on owner

The question really is, "How transferable is the benefit stream?" This is best addressed by finding, keeping and motivating key employees.

3) Other indicators of risk:

- Business and industry growth
- Economic conditions; national, local & industry
- Type of business
- Barriers to entry for new competition
- Sensitivity of customer base
- Business location and facilities
- Competition
- History of business
- Local market penetration, how dominant is your business in the market
- Product diversification

The following tables illustrate the increase in value that can be obtained by incorporating some basic business valuation tools into your planning.

For example, Table 1 illustrates that a company can increase in value by \$1,000,000 by increasing its cash flow by \$50,000 per year for 5 years. Table 2 illustrates the effect of decreasing

investors' risk by 1% per year for 5 years and Table 3 illustrates the combined effect of improving cash flow and decreasing investor's risk.

TABLE 1:

Year	Cash Flow	Risk	Value
2005	\$500,000	25%	\$2,000,000
2010	\$750,000	25%	<u>\$3,000,000</u>
Increase in Value			<u>\$1,000,000</u>

TABLE 2:

Year	Cash Flow	Risk	Value
2005	\$500,000	25%	\$2,000,000
2010	\$500,000	20%	<u>\$2,500,000</u>
Increase in Value			<u>\$500,000</u>

TABLE 3:

Year	Cash Flow	Risk	Value
2005	\$500,000	25%	\$2,000,000
2010	\$750,000	20%	<u>\$3,750,000</u>
Increase in Value			<u>\$1,750,000</u>

Creating value is a process. There is really nothing extraordinarily difficult. However, it does take patience, focus, a long-term perspective and consistent application. Start planning now. By setting benchmarks to measure critical value drivers, value can be tracked and increased over time.

By: Thomas G. Stevenson, CPA/CVA, a business valuation specialist with over 25 years of public accounting and business valuation experience. Tom can be reached at: Barbich Longcrier Hooper & King Accountancy Corporation, 100 Cross Street, Suite 300, San Luis Obispo, CA 93401, (805)782-5239, toms@blhk.com

(but perhaps not all) of the “answers,” find a way to gently direct their attention there, such as “Well, let’s take a look at that section in the manuals and see if it helps – Do you have your copy up on your computer screen? Okay, turn to Section 3.2.6.”

- Be an involved listener
Being an involved listener is hard work. It means not doing any other work and focusing on the other person. To be candid, “multitasking” usually doesn’t work, at least when we’re dealing with other human beings, who will very quickly pick up on the fact that they don’t have your full attention - just as you do in your professional and personal lives.

You must listen carefully to what the other person is saying. Don’t guess at the meaning and make dangerous assumptions. Be sure the conversation remains focused on the matter, not the person. Often, we will try to identify what the person’s ulterior motives are and what the behavior is revealing. Stop that!. As Freud said, “Sometimes a cigar is just a cigar.” Stay with the matter at hand.

- Be open to the franchisees’ ideas
The best way to keep the communication flowing is to invite it. And the best way to invite it is to be open to others’ ideas. A franchise system will grow stronger with new ideas and the best new ideas come from the franchise operators.

Be open to others’ ideas. A franchise system will grow stronger with new ideas, and the best new ideas come from the franchise operators. Listen to them and see a new way to do things. Acceptance is a form of respect that the franchisees will respond well to. In fact, you might consider giving awards for great ideas at your next convention. Almost everybody loves public praise.

- Drop in and see them
There is no higher compliment that can be paid to a franchisee than to spend your time with them. A face-to-face allows you to read the franchisees facial and body languages. That will tell you more of what the franchisee is trying to communicate. It is also a sign of respect that will be returned often. But even if it isn’t returned, it’s still the right thing to do, so don’t be too concerned if the franchisee isn’t as professional as you are.

- Use the communications channel that is most convenient for the franchisees.
In today’s world there are many channels of communication available to us. We can use print, voice mail, conference calls and the Internet. Choose the media that are the most convenient for the franchisees, not the office staff. If your franchisees are online then the Internet will give you the most immediate and cost-effective results. But do not force them into a method that services you, not them, and may involve costly investments by them that they will not appreciate in the immediate future.

There is no secret to clear and open communication - it is about people. Respect your franchisees and keep a strict rule of honesty; treat your franchisees the way you’d want to be treated. If your roles were reversed and you “talk to the hand,” it will be a hand offered palm up in a gesture of trust and cooperation.

Mary Ann O’Connell is the owner of O’Connell and Company a franchise consulting company with more than 25 years of franchising experience. She can be reached at 714.434.1516 or mary-ann@oconnellco.com, www.oconnellco.com

FRANCHISE LEGAL UPDATES

U.S. LEGAL UPDATE

Does My Arbitration Clause Really Cover All I Think It Does?

While arbitration clauses can be useful dispute resolution tools, they require careful drafting to anticipate the maximum range of disputes; otherwise, some claims may still be decided by a court or jury.

Many franchisors use arbitration clauses in their agreements to try to minimize their chances of being involved in jury or other court trial. It is difficult to know, however, exactly which kinds of disputes are covered by the arbitration clause and which are still subject to the jurisdiction of a court.

A recent case [[Campbell v. TES Franchising, LLC](#) (Ohio - 2005) CCH Business Franchise Guide ¶ 13,071], serves as a warning of the dangers of an arbitration clause that is not broad enough in its coverage.

The case involved a dispute between a franchisor in the franchise consulting business and one of its franchisees, relating to whether or not the arrangement was subject to the Ohio Business Opportunity Purchasers Protection Act and whether the franchisor had violated the Act in certain technical regards.

The Ohio appellate court held that these claims, based on the Ohio Act, were not subject to the arbitration clause contained in the franchise agreement, since the clause related only to “disputes and claims relating to this agreement, the rights and obligations of the parties hereto, or any claims or causes of action relating to the performance of either party ...” In the court’s view, the claims merely concerned the applicability of a state statute to the agreement and, therefore, were outside the arbitration clause.

The court's decision is certainly subject to reasonable criticism. After all, why is the dispute regarding the possible application of the Ohio law not a dispute regarding "the rights and obligations of the parties" and the language merely indicates which parties are involved in the dispute?

However, in any event, the case does serve as a reminder that if a franchisor wants to include as many disputes as possible under arbitration, and should be careful to use language. At the same time, note that many specific franchisors intentionally exclude certain types of disputes from arbitration, such as those related to their trademark or other brand-specific issues.

INTERNATIONAL LEGAL UPDATE

GREECE

Greece prepares itself for a new franchise law. Preliminary indications are that it will include disclosure and registration requirements.

Word has reached us, from one of our correspondent firms in Europe, that the Greek government has begun the study of a possible new franchise law. Although the details are not clear, and no draft document has been made available to us, the law may include requirements for both pre-sale disclosure and registration. Unknown is whether or not the law would include restrictions related to relationship issues, such as termination, renewal, etc.

No date for circulation of a draft or enactment is known, but we'll keep you informed as we learn more.

LITHUANIA

Lithuania enacts restrictive franchise relationship law, significantly affecting common franchise relationships.

For those franchisors considering franchising in Lithuania (there must be at least a few out there!), or who have franchisees there, certain negative provisions of the Civil Code of Lithuania will be of interest, and may be troubling for those contemplating franchising in Lithuania.

The Code provides that, on the expiration of a franchise agreement, a franchisee who has performed its duties under the agreement has the right to execute a new contract for a new term under the same conditions. While the franchisor can refuse to grant the new term, the condition for doing so is that the franchisor cannot, for three years, award a similar contract covering the same territory; if the franchisor does so, it can be liable for damages. Additionally, a new contract awarded to a franchisee cannot be more "onerous" for the franchisee than the earlier one.

Under this provision, an open question is whether or not, in many practical business situations, it may force a Franchisor to retain a franchisee beyond the agreed-upon duration of the agreement, and if, in some situations, this might not be construed as requiring an "infinite" franchise!

In addition, the law provides for registration of franchises, which is not an unusual element in many franchise laws, although the registration process is often far different than exists in the U.S.

Finally, the definition of "franchise" under the law is exceptionally broad, including, arguably, rights to commercial or industrial information, even in the absence of the right to use a name or trademark.

These provisions certainly raise significant negative considerations in any franchisor's decision to expand into Lithuania, and may curtail franchising activities there.

CANADA

Franchise Disclosure Bill Proposed in New Brunswick

Within the last few years, there's been a continuing trend for many foreign jurisdictions to adopt, or propose adopting, franchise disclosure or registration legislation, sometimes including elements regulating the franchise relationship as well. Some of these proposals and laws are similar, in broad outline, to those in the U.S.

The province of New Brunswick, Canada, is the latest jurisdiction to join this trend with a proposal submitted on June 28, but not yet adopted.

The proposed New Brunswick Franchise Act covers franchise awards (and, interestingly, renewals or "extensions") where the franchise business is operated wholly or partially in New Brunswick. The bill includes provisions for pre-sale disclosure, rescission and damages for misrepresentations or non-disclosure, an obligation of "fair dealing" on both parties to the franchise agreement, and rights of franchisees to form associations. These elements of the bill are, of course, similar to existing franchise laws in the United States, Canada and other countries. The actual content of any required disclosure document would be determined only after the bill is passed.

An unusual component of the bill is its dispute resolution requirement, mandating informal attempts by the franchisor and the franchisee to resolve the dispute and, if that is not successful, allowing either party to require mediation. This provision is somewhat similar, in broad philosophy, to that already used in Holmes & Lofstrom's model Franchise Agreement and is probably unique in the world's franchise laws.

What are the bill's chances for passage? Probably not very high, at the moment. Canadian counsel

Continued on page 9

Mediation and Arbitration Myths

By: David E. Holmes, Partner,
Holmes & Lofstrom, LLP

Disputes are inevitable even in the best-managed franchise systems, since no business relationship involving hundreds (or thousands) of participants is immune from the human tendency to have differences (sometimes serious) of opinion. These differences can range from simple disputes over operational matters to serious questions regarding the development and direction of an entire franchise system.

Given the fact that very few disputes can be resolved through simple, face-to-face discussion, mechanisms for concluding those disputes are required. To do this, many franchise systems have chosen, in their franchise agreements or elsewhere, to adopt different forms of Alternative Dispute Resolution. Generally, these involve alternatives to traditional court litigation, often including mediation and/or arbitration.

Mediation usually involves the use of a trained mediator, not representing either party but assisting each of them in reaching agreement. While the franchisor and franchisee (often represented by lawyers) may be required to attend mediation, and probably share its costs, the mediator does not issue any binding decision and, if the parties do not reach agreement, then no decision will be imposed on them by the mediator.

Arbitration is different. The arbitrator is usually authorized to issue a binding decision, just like a judge, and that decision can be enforced in court, often with very little review by a judge and little chance of reversal. The arbitrator can be a retired judge, a lawyer or other professional, and he or she may or may not have a background in franchising.

Let's explore some of the myths sur-

rounding mediation and arbitration, and compare them to reality.

Myth No. 1: Mediation is a waste of time and money since no decision can be forced.

While there's no guarantee the mediation will result in an agreement between the franchisor and franchisee, experience shows that, the majority of times, it does. Typically, mediation results in resolution of many, if not all, of the issues in dispute, often through compromise, and may work to preserve the underlying business relationship.

Does that mean that both sides get exactly what they want? Of course not. But it does mean that they reach a mutual accommodation that's preferred by both of them to the risks and costs of litigation, including potentially damaging the business relationship beyond repair.

Since mediation expenses are almost always far less than litigation, the business calculation is easy: spend a relatively few dollars on a method (mediation) that has a good track record in settling disputes, without placing yourself in a situation where the result will be imposed on you without your consent.

Myth No. 2: Mediation always makes good sense and should always be used.

Some disputes are truly of a philosophical nature, and the parties are so far apart that agreement is highly unlikely. Also, in some situations, a party is attempting to "send a message" or establish a legal precedent.

In those cases, which are generally the exceptions, a privately brokered agreement, even one reached with the help of a mediator, may not serve all of the parties' needs and formal arbitration, or even litigation, may be the only real alternative.

Myth No. 3: Mediation Works Best When the Mediator Knows Nothing About the Type of Dispute, the Busi-

ness Context, the Parties or Their Lawyers.

At its best, mediation is an art, the art of persuading two (or more) business people, and sometimes their lawyers, that compromise and agreement makes better sense than a fight to the finish.

The mediator should have as much knowledge as possible regarding every aspect of the disagreement, including items the parties and their lawyers may not even have thought of, constantly pushing the parties to a creative resolution.

A competent mediator is not committed to any particular solution, but he or she is highly committed to reaching some solution that is accepted by all concerned. To do this, he or she needs as many tools as possible, and knowledge is key.

Myth No. 4: Arbitrators tend to "Split the Baby" in making decisions, never giving either side what it really wants.

Arbitrators today, in franchise disputes, seem to be quite willing to make strong decisions, including significant damage awards. This sometimes makes the losing side wish that it had had an opportunity to present its case to a jury. Of course, such strong decisions are usually seen by the parties to the dispute as a good or bad feature, depending on whether they've won or lost.

Myth No. 5: Arbitration is quicker, cheaper and better than litigation.

Franchise litigators with extensive arbitration experience report that arbitration can be, (and often is) cheaper than litigation. But cases can be cited total costs (filing fees, lawyers, experts, arbitrators, etc.) were as high or higher than in litigation before a judge. Cases tried to a jury generally tend to be the most expensive.

Continued on page 9

tells us that the bill was introduced by the minority party in the provincial legislature. As such, it's really in the nature of a "suggestion" to the provincial government and there's no assurance that it will be adopted into law. In addition, New Brunswick has a population of only 750,000

and is not considered to be an economically significant market, so, even if adopted, its commercial impact on international franchising would be small.

However, we're also told that the province we should keep our eyes

on in British Columbia, which is economically very significant and where there may be similar developments this fall. The New Brunswick proposal may be a "sneak preview" of similar proposals or laws elsewhere in Canada, and we'll keep you informed.

Myths, continued from page 8

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In fact, arbitrator's fees can be high, and the judge's salary is paid by the government. Experienced litigators agree that considerations of possibly lower costs in arbitration should not be the over-riding reason to choose arbitration and that other factors are more significant. We've heard of situations in which one side files its arbitration papers, pays its half of the fees, the other side refuses to pay its share and the arbitration organization requires that the filer pay the other half to proceed noting that it may recover the amount in an award at the conclusion of the arbitration.

As to quickness, while that may once have been a consideration, lawyers who handle both arbitrations and court cases generally see few differences in this area, especially given states' efforts in the past few years to bring lawsuits promptly to trial. Arbitration agreements that require a panel of multiple arbitrators will generally result in greater costs and longer proceedings.

Myth No. 6: Arbitrators don't have to follow the law, so their decisions are unpredictable.

There certainly are cases in which a court has confirmed that an arbitrator is not generally required to follow or apply the law in the same way as a judge. Therefore, at least in broad measure, an arbitrator probably has more freedom in reaching a particular decision, and is less subject to being over-ruled or reversed, than a judge.

However, this issue can be partially addressed by including in the arbitration (or franchise) agreement a clause providing that the arbitrator is required to follow applicable law, and that any failure to do so is an act by the arbitrator in excess of his or her authority. Some arbitration agreements even include (and some arbitration authorities and litigators recommend) an appeal mechanism, to a panel of arbitrators, if one side or the other believes that the arbitrator ignored the law.

Myth No. 7: Arbitration can be completely confidential.

While this can be true of mediation, it's only partly true of arbitration.

Mediation, and its results, are generally confidential (mediators usually have a confidentiality obligation, as an ethical matter) and a franchise agreement can provide for this.

Unlike a court trial, the public and the media are not able to attend arbitrations. If one of the parties to the arbitration is a franchisor, and the arbitration concerns matters of the type reportable in the UFOC, then specific information about the arbitration, and its outcome, will usually need to be reported in the franchisor's UFOC.

Myth No. 8: Litigation never makes sense, arbitration is the only way to go.

Some disputes are so important that one or more of the parties feel that they're simply more comfortable having a judge manage the decision-making process. For example, most franchisors would be uncomfortable having an arbitrator decide the validity of their system's core intellectual property rights, such as its trademarks, while franchisees may feel that a class action is better managed by an experienced federal judge. In those situations, each side may have a reasonable argument for not using an arbitrator.

Clearly, the better course is for each franchise system to sit down with their attorneys, discuss the advantages and disadvantages of arbitration (a topic better saved for an article in the future), and make a rational business decision.

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