AAHOA 2008 PROGRESS REPORT ON ACCOR HOTELS FAIR FRANCHISING COMPLIANCE

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Every month, for the past year, I have reviewed each of AAHOAs 12 Points of Fair Franchising and reported on them on the Hotel Interactive website. At the recent AAHOA Convention in San Antonio (March 26-29), AAHOA released its long-awaited Performance Appraisal Report (PAR) which evaluates the franchise agreements of five leading franchise companies including Accor, Carlson, Choice, La Quinta and Wyndham. The object of this report is to determine how they complied with the 12 Points of Fair Franchising.

Why is this important? Since AAHOA members own approximately 13,500 franchised hotels and have long-term franchise agreements with their franchisors, fair franchising is an essential factor in profitable operations.

In preparing its PARs, AAHOA utilized the Uniform Franchise Offering Circulars (UFOCs), actual franchise agreements and related business policies and procedures.

Following preparation of draft versions of the Performance Appraisal Report, AAHOA provided each franchisor with a copy of the report and an opportunity to comment on it. The comments received by AAHOA were considered and, if pertinent, were integrated into the Performance Appraisal Report.

This long-awaited (and some would say long-overdue) report enables franchisees to better understand the provisions of the franchise agreements so that they can make informed decisions before signing a franchise agreement and committing to a long-term franchise relationship.

Here is a summary of the performance appraisal of ACCOR Hotels International as compared to AAHOAs 12 Points:

Point 1: Early Termination and Liquidated Damages

1(a) Most franchisors assess liquidated damages at unfair and punitive rates often 36 to 60 months of royalty fees. AAHOA states that franchisees should only have to pay 6 months of royalty fees.

> ACCOR POSITION: In its 2006 UFOCs and franchise agreements, Accor provided that after the first 12 months, liquidated damages ("LDs") would equal the average monthly Royalty fees multiplied by 36 or the number of months remaining under the agreement. After reviewing the PAR and meeting with AAHOA executives on several occasions on November 12, 2007 Accor agreed to reduce the amount of LDs to equal the average monthly Royalty fees multiplied by 24 months or $75,000 whichever is greater.

1(b) Windows Provisions- Most franchise agreements contain "window" or additional termination right provisions which allow the parties to terminate the agreement on specific anniversary dates (e.g. on the fifth, tenth or fifteenth anniversary) without having to pay liquidated damages. Unfortunately, many franchisors have included "gotcha" clauses in their franchise agreements which prevent early termination if the franchisee encountered monetary or operational problems at any time after the opening of the facility.

> ACCOR POSITION: In its 2007 UFOC and franchise agreement, Accor included provisions which allow a Franchisee to request and obtain windows provisions. Accor also offers its Franchisees the option of exiting the system with substantially-reduced liquidated damages ("LDs") if they provided appropriate notice and had experienced low occupancy rates during the preceding 12 months.

1(c) Underperforming Properties-

> After a motel has been in operation for 2 years, and is in compliance with the terms of its franchise agreement, Motel 6 offers its Franchisees various options to terminate the franchise agreement early based on average room occupancy rates for the prior 12 consecutive months, as follows: (i) if occupancy rates are less than 50%, by giving 30 days notice, a Franchisee will not have to pay any LDs; (ii) if occupancy rates are greater than 50% but less than 60%, by giving

one year's notice, a Franchisee will not have to pay any LDs; and (iii) if occupancy rates are more than 60% but less than 70% by giving 30 days notice, a Franchisee will have to pay LDs that are equal to the total Royalty fees paid during the prior 24 months.

2. Impact/Encroachment/Cross Brand Protection All franchisors should grant each of their franchisees (over the term of the agreement) contractual rights to a geographic "area of protection" (AOP) in which the franchisor will not allow another property to operate with the same or similar brand name as the franchisees hotel.

ACCOR POSITION: Although Accor grants a "Protected Territory" to its Franchisees that is not dependent on any achievement of sales volume or market penetration, Accor does not allow its Franchisees to request an impact study if the applicant hotel is outside of the Protected Territory. Following its review of the PAR and meeting with AAHOA leaders, Accor agreed that it will allow its Franchisees to submit impact comments and feedback, will monitor the situation, and if impact is proven by the existing motel after the new facility has been in operation for a reasonable period of time, Accor will consider concessions to the impacted Franchisee.

3. Minimum Performance & Quality Guarantees If a franchisee's hotel is not able to maintain certain occupancy levels over a designated period and has not received a minimum level of reservations, franchisee should be able to terminate the agreement without penalty.

ACCOR POSITION: In Accor's 2006 and 2007 UFOCs and franchise agreements there are no provisions that if a hotel fails to receive a minimum number of reservations through Accor's central reservation system, or if the quality of a hotel brand name declines or changes, Accor will allow the Franchisee to exit the system without penalty pursuant to certain conditions if their occupancy rates are less than 50%. In its written feedback letter to AAHOA dated February 2, 2007, Accor responded as follows: "it is our belief that we don't need to give occupancy level and res system performance guarantees. Motel 6 in particular, is not a reservation-driven brand. The

question a prospective franchisee should ask is “Does the brand deliver?” not “Does the res system deliver?” If the sign goes up and its increases occupancy, then the brand is delivering. We deliver…” AAHOA acknowledges Accor’s response and agrees that it is important to focus on the performance of the Franchisors themselves and how the Franchisors play a large role in the success or the failure of their individual Franchisees and the franchise system overall.

4. QA Inspections/ Guest Surveys

ACCOR POSITION: Following its review of the PAR and meetings with AAHOA executives, Accor provided information concerning its current practices, revised its franchise agreement and implemented a new policy. Specifically, Accor explained that its brand standards are comparable for both corporate and franchised locations and it enforces them. Accor reported that it has mandatory quality programs for corporate locations and mandatory quality training for Franchisees. In the corporate stores, compliance affects compensation and bonuses. The same inspectors conduct the assessments for both the corporate and franchised properties and they use the same measurement tools. In addition, the focus of Accor’s QA measurements is guest-service related. Accor utilizes the QA measurements to provide feedback for management improvement rather than focusing on punitive measures. Accor also agreed to review the language contained in its UFOCs and franchise agreements regarding use of these measures to assure that is accurately reflected the design, purpose and use of these QA measures. Accor subsequently made changes to its franchise agreement related to quality measures (see, revised Section 13.1.1 of the 2007 Franchise Agreement), and agreed to institute the following procedure and post it on the Franchisee extranet. .

“Before we issue a Default and Termination letter to a franchisee solely on the grounds that the franchisee has failed to maintain minimum required quality scores (QSM, GSS, CRN), we will notify the franchisee of our intent to do so. If requested by the franchisee, we will ask the Franchise Advisory Council to

review the factors included in the scores and comment on the application of the scores/tools in the particular circumstances."

5. Vendor Exclusivity

ACCOR POSITION: In general, Accor allows its Franchisees to purchase conforming goods from any vendor, not just those mandated by Accor. To the extent Accor believes its is necessary to mandate vendors for the purpose of establishing standards and specifications for the hotel brands, Accor reported that it strives to ensure that the Franchisees are receiving competitive prices. Finally, since Accor receives rebates or payments from the vendors, Accor actually issues rebate checks to its Franchisees from the revenues it receives from vendors.

6. Disclosure and Accountability

ACCOR POSITION: Accor does not provide its Franchise Advisory Councils ("FACs") with audited financial statements concerning the expenditure of marketing and reservation fees. Accor, however, consults with the FACs on Accor's marketing strategies and does not use the fees to defray any general operating expenses. Following its review of the PAR and meeting with AAHOA executives, Accor also clarified the language in its 2007 UFOCs and franchise agreements regarding how it accounts for and uses the advertising fees, and committed to providing a report of the receipts and expenditure of these fees annually. (See, Section 10.1.3 of the 2007 franchise agreement and the excerpt from item 11 of the UFOC).

7. Maintaining Relationships with Franchisees

ACCOR POSITION: Accor's Franchise Advisory Councils ("FACs") are comprised of corporate representatives and representatives of the Franchisees who are in "good standing" and are elected by the Franchisees themselves. In response to AAHOA's updated 12 Points of Fair Franchising and the Initial PAR, a team of Accor executive personnel met with AAHOA on several occasions to discuss the updated Points and the PAR itself. AAHOA looks forward to developing a closer working relationship with Accor in upcoming

years. Finally, to further enhance its relationships with the Franchisees and AAHOA members, Accor agreed to become more familiar with AAHOA's Certified Hotel Owner ("CHO") program and determine whether it will recommend this program to its Franchisees.

8. Dispute Resolution Franchisors should agree to participate in a non-binding mediation. If mediation is unsuccessful, the dispute should not be submitted to binding arbitration unless all the parties agree to do so.

If binding arbitration is not agreed upon, any party should be free to pursue its claims in a court of law. There should be no waiver of the right to a jury trial, no caps on the amount of damages or punitive damages.

ACCOR POSITION: Accor has nearly comp0lied with AAHOA's Point No. 8 with respect to the process to trying to resolve disputes, including a process for resolving disputes internally, and if that is unsuccessful, proceeding to mediation at a location near the subject motel. AAHOA applauds these provisions in the franchise agreements.

Accor has also included provisions in its franchise agreements requiring the Franchisee to waive their rights to a jury trial and to waive their rights to assert claims for punitive damages. As Accor is fully aware, such provisions not only require Franchisees to give up important legal rights, but also preclude Franchisees from obtaining the best legal counsel available to them. Indeed many franchise attorneys will not accept a case on a contingency fee basis if the Franchisee is unable to assert the right to a jury trial and is less likely to collect punitive or exemplary damages based on a Franchisor's fraud, malice or oppression.

9. <u>Venue and Choice of Law Clauses</u> The party pursuing its claims in a court of law should do so in the country and state in which the subject facility is located.

> <u>ACCOR POSITION</u>: Accor provides that the venue for any disputes shall be at a location or in the judicial district in which the subject motel is located, but requires that the laws of the state of Texas shall govern the proceedings.

10. <u>Franchise Sales Ethics and Practices</u> All franchisors should mandate fair and honest selling practices among their salespersons and agents. It is unfortunate that many first-time franchise applicants do not fully understand that the agents of the franchisors will sometimes make oral promises that are not included in the franchise agreement.

> <u>ACCOR POSITION</u>: Following its review of the PAR and meeting with AAHOA executives, Accor explained that the goodwill of the whole system is its primary concern. It does not churn franchises. During the sales process, after a franchise agreement is sent to a Franchisee, Accor surveys the Franchisee about the sales process, to find out whether he or she received good service and whether he or has any suggestions for improvement. Further, Accor stated that although it does not believe it is necessary to include a "good faith or fair dealing" clause in its franchise agreements, Accor operates according to the Accor values and core beliefs, including trust, performance, respect, transparency, responsibility, and professionalism. These values and core beliefs govern all Accor employees and functions worldwide, and they form part of the Owner Orientation and Manager Training program Accor provides to its Franchisees. Finally, in order to avoid any misunderstandings concerning the terms of the "deal", Accor agreed to change its business practices to require all potential Franchisees to sign a document containing the agreed-upon "deal points". Specifically prior to meeting with AAHOA, Accor required its Franchise Developers to execute and submit a document containing the agreed-upon "deal points" that had been reached with a potential Franchisee, which Accor then reviewed and revised, as necessary. The Accor legal department would subsequently prepare the subject franchise agreement based on the final approved version of the deal points document.

11. Transferability

- Transfer fees should be fair and reasonable (i.e., generally no more than $1500).
- There should be no fees for a transfer to a spouse, child, parent, sibling, niece, nephew, descendent, spouse's descendent or other family member.
- There should be no fees for a franchisees buyout of other shareholders or partners.
- In the event of a requested transfer, the franchisor should not demand an extensive renovation of the hotel. Any required renovations should be limited to those specific items identified in the last two Quality Assurance inspection reports issued prior to the requested transfer.

> ACCOR POSITION: Following its review of the PAR and meetings with AAHOA executives, Accor made several changes to its 2007 franchise agreement, including, among other things, (a) reducing the transfer fee from $10,000 to $7,500, which allowed a Franchise to receive an incentive credit of $5,000 if the Franchisee satisfied certain conditions, (b) adding language that would allow a Franchisee to make a convenience transfer, or would allow a majority owner to acquire or purchase the interest of one or more minority owners, without paying a transfer fee, and (c) clarifying the procedures for death-time transfers.

12. Sale of the Franchise System Hotel Brand The new franchisor should maintain the same or higher level of quality as the prior franchisor owners and offer assurances that the transition is an smooth as possible.

> ACCOR POSITION: Following its review of the PAR and meetings with AAHOA executives, Accor explained that because Accor or its affiliates own and operate the vast majority of the motels of each brand they franchise, working with a new owner for the benefit of the Franchisee would be a business practice that would be in Accor's best interests, as well as those of its Franchisees. Accor asserted that it is in the interests to maximize value in the entire brand, whether on an ongoing operational basis or at the time of any sale. Accor also reported that it intends to review its language on assignment to determine whether it is appropriate to add language related to working with

any assignee to assure a smooth transition. Unfortunately, Accor ahs not yet agreed to add such language to its franchise agreements.

Stanley is available as a featured speaker on the following subjects:

- Fair Franchising is Not an Oxymoron
- Great American Hotels and Hoteliers
- Are Exterior Corridor Hotels Obsolete?
- Impertinent Questions in Search of Pertinent Answers
- AAHOAs 12 Points of Fair Franchising

Stanley Turkel, MHS, ISHC operates his hotel consulting office as a sole practitioner specializing in franchising issues, asset management and litigation support services. Turkel's clients are hotel owners and franchisees, investors and lending institutions. Turkel serves on the Board of Advisors and lectures at the NYU Tisch Center for Hospitality, Tourism and Sports Management. He is a member of the prestigious International Society of Hospitality Consultants. His provocative articles on various hotels subjects have been published in the Cornell Quarterly, Lodging Hospitality, Hotel Interactive, Hotel Online, AAHOA Lodging Business, etc. If you need help in negotiating a franchise agreement or with a problem such as encroachment/impact, termination/liquidated damages or litigation support, call Stanley at 917-628-8549 or email stanturkel@aol.com.