Fair Franchising Is Not An Oxymoron: No. 8

By Stanley Turkel, MHS, ISHC

In 1998, the Asian American Hotel Owners Association identified a set of standards called the 12 Points of Fair Franchising by which to judge the actions of franchise companies. Now, nine years later, AAHOA has updated the 12 points and has embarked on a survey of franchisors to assess their compliance with these fair franchising standards. In this Hotel Interactive article, I highlight Points 9 and 10:

Point 9: Venue and Choice of Law Clauses.

In the event a dispute between a Franchisor and Franchisee has not been resolved by participating in an informal, in-person meeting with authorized representatives from the parties, or by participating in mediation proceedings, 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. Further, any lawsuit or claims should be governed by the laws of the country or state in which the lawsuit or claims are filed.

Turkel Comment: Does it matter if your franchise agreement specifically states that disputes shall be resolved in a court in the franchise company's headquarter state? You bet it does and in the franchisor's favor. The company attorneys know the judges and arbitrators in their HQ city. Furthermore, imagine the extra expense involved if your hotel is on the east coast while the franchise company is located on the west coast. The time to avoid this problem is when you are negotiating the franchise agreement which should state specifically that any legal proceeding will be pursued in the state where the subject hotel is located.

Point 10: Franchise Sales Ethics and Practices.

Franchisors should mandate fair and honest selling practices among their salespersons and agents.

Franchisors should use their best efforts to identify whether any of their sales agents, or any persons acting on behalf of the Franchisors, made any oral or written representations or promises

to any Franchisee applicants, or reached any agreements with any Franchisee applicants, that are not contained in the proposed franchise agreements. To the extent any salesperson or agents made any oral or written representations or promises, or reached any agreements, with a Franchisee applicant, they should be set forth in writing and attached as an addendum to the particular franchise agreement.

Franchisors should include contractual provisions in their franchise agreements that grant a Franchisee all rights, title and interest, in its own guest lists, and in all related information for guests that have stayed at the Franchisee's particular Facility, which survives the termination of the franchise agreement. Franchisors should not use any database developed from one hotel brand to market or sell their other hotel brands to the detriment of the Franchisees.

Franchisors and their salespersons and agents should not engage in the practice of "churning" properties, i.e., seeking the early termination of an older hotel on the basis of low quality assurance (QA) inspection scores or otherwise, so the Franchisor can then seek and approve an application of the conversion of a newer hotel, or the construction of a new hotel, with a particular brand name in the same geographic region or area of protection (AOP) as the older hotel for which the Franchisor is seeking an early termination.

Commentary: It is an unfortunate situation in franchising that many first time or "rookie" Franchisee applicants do not fully understand that the salespersons or agents of the Franchisors will sometimes make oral representations or promises about the Facility, the franchise system, the franchise agreement or the License that are not included in the proposed franchise agreement. Regrettably, because these first-time Franchisees applicants trust and believe that the Franchisor's salespersons or agents will honor their oral representations and promises, the applicants do not carefully read the lengthy and sometimes complex franchise agreements to determine whether such representations and promises have been included in their own agreements.

In the interest of fair franchising, prior to the execution of the franchise agreement, a Franchisor should ask a Franchisee applicant to prepare a written document that identifies any oral or written representations or promises made by, or agreements reached with, the Franchisor, its sales agents, or any persons acting on behalf of the Franchisor, and that are not contained in the

franchise agreement. This written document should be attached as an addendum or exhibit to the franchise agreement.

If the Franchisee applicant does not identify any such representations, promises or agreements, the Franchisor should ask the applicant to carefully review and initial the paragraphs in the franchise agreement which explicitly state that (1) neither the Franchisor nor any person acting on its behalf has made any representations or promises on which the applicant Franchisee is relying that are not written in the agreement, and (2) the agreement, together with the exhibits and schedules attached, is the entire agreement superseding all previous oral and written representations, agreements and understandings of the parties about the Facility, the franchise system, the franchise agreement and the License.

Turkel Comment: The so-called merger and integration clause means that any verbal promises, claims or representations which are not contained in writing in the franchise agreement are not enforceable. Never mind that your franchise salesman said that you have an exclusive area of protection. If it's not in writing in the franchise agreement, the franchise company can grant another franchise in your market area. Once again, the time to negotiate this issue is before you sign the license agreement.

The practice of "churning", that is termination of older properties so that the franchise company can replace them with newer hotels, mostly affects exterior corridor hotels. This is a quiet but potentially explosive controversy simmering just below the surface of the hotel franchising industry. It concerns the defranchising of exterior-corridor properties, once the standard motel design and whether the traveling public considers them insecure and outdated.

Some franchise companies are defranchising these motels to take advantage of current market conditions and the possibility of franchising newer and more modern properties.

Unfortunately, there is no published reliable data regarding many of the questions involved in this controversy:

- How many exterior-corridor properties are in operation in the U.S.?
- What do travelers think about exterior-corridor properties?
- Are these properties considered outdated and undesirable?

- How many guests still would rather park close to their rooms so they can
    - see their automobiles and their possessions
    - have a short walk with their luggage
    - have the privacy and convenience of avoiding hotel lobbies, elevators and long interior corridors?
- Do women guests believe that interior corridor hotels are safer?

There are an estimated 500,000 brand-affiliated, exterior-corridor hotel rooms now operating in the United States. If you add in independent properties, there are probably 750,000 rooms, or 40 percent of all domestic hotel rooms. At a 50 percent occupancy and $50 Average Daily Rate, these hotels generate nearly $6 billion in annual room revenues and pay $180 million in royalty fees (using a conservative three-percent franchise fee).

In light of their constant claims of fairness in franchising, how can franchise companies reconcile their rhetoric with the painful reality facing hotel owners whose exterior-corridor properties are losing value every day?

The hotel industry badly needs primary research on consumer preferences for exterior corridor hotels. Franchisors and franchisees should sponsor such research under the aegis of one or more of the following: the American Hotel & Lodging Association, The Cornell Center for Hospitality Research, the NYU Tisch Center for Hospitality, Tourism and Sports Management and/or other hotel graduate schools at major universities.

Better yet, the Asian American Hotel Owners Association should undertake this research effort on behalf of its 8,300 members.

Stanley Turkel, MHS, ISHC operates his hotel consulting office as a sole practitioner specializing in franchising issues, asset management and litigation support services. If you need help with a hotel franchising problem such as encroachment/impact, termination/liquidated damages or litigation support, call Stanley at 917-628-8549 or email stanturkel@aol.com.

Stanley will be speaking on the program of the CHOC Owner's Summit in Dallas, TX April 6-8, 2008.