

## **Fair Franchising Is Not An Oxymoron: No. 5**

**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 Point 6:

### Point 6: Disclosure and Accountability

There should be greater franchisor disclosure and accountability concerning the expenditure of marketing and reservation fees collected from franchisees. On an annual basis, franchisors should disclose how the marketing and reservation fees are spent, including identifying the specific products and services that are paid for with the fees. A franchisor should not profit directly from the marketing and reservation fees it collects from the franchisees or use such fees to pay for marketing and advertising related to a franchisor's sale of hotels.

### Turkel Comment:

Ten years ago, a North Carolina federal court jury awarded the franchisees of Meineke Discount Muffler Shops a verdict of \$347 million including \$150 million in punitive damages. In summary, the lawsuit began in 1993 when 2,500 Meineke franchisees filed a class action suit against Meineke, its in-house advertising company and several corporate officers, as well as its parent company, the British conglomerate GKN, P.L.C. under its franchise contracts, Meineke promised that it would serve only as a "conduit" for the advertising funds and would use all the money to place ads. Instead, Meineke placed the advertisements through its wholly-owned subsidiary, New Horizons Advertising. The franchisee class action alleged that Meineke misappropriated millions of dollars by secretly retaining discounts on advertising as "commissions". After a six-week trial, the jury found that Meineke had breached its fiduciary duty to the franchisees and committed fraud by secretly diverting millions of dollars to its own benefit.

Ultimately, the Meineke decision was overturned on a technicality. However, the specter of fiduciary duty still hovers since many hotel franchise companies perform bookkeeping, collection, payroll or accounting services for their franchisees. Many administer or supervise a pooled advertising fund into which franchisees are required to contribute. This fiduciary obligation, along with the duty of due care, appears to apply without regard to the intent of the parties or the language of the franchise agreement. Franchisors can avoid such exposure by segregating the advertising fund and keeping it in a separate account that can be audited annually by the franchise advisory council. Other smart franchisors have created Advertising Councils where franchisee members meet with the corporate staff to plan advertising campaigns and spending. After all, since franchisees are closer to the system's customers, they are in a better position to say what kind of advertising will be most effective.

Incidentally, after the litigation, Meineke negotiated a new franchise agreement with the independent franchisee association and has since received the Fair Franchising Seal from the American Association of Franchisees and Dealers.

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 at the NYU Tisch Center for Hospitality, Tourism and Sports Management. If you need help with a hotel franchising problem such as encroachment/impact, termination/liquidated damages or litigation support, don't hesitate to call Stanley at 917-628-8549 or email [stanturkel@aol.com](mailto:stanturkel@aol.com).

If you would like to reserve an autographed copy of Mr. Turkel's new book, "Great American Hoteliers: Pioneers of Hotel Industry" (to be published at the end of 2007), send an email to [stanturkel@aol.com](mailto:stanturkel@aol.com).