Franchise Documents Should Not Be Cookie Cutter Products

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When Professor Arthur R. Miller taught Civil Procedure at the University of Michigan, before moving to Harvard Law School and later NYU Law School, his students used to pester him with the question, "What does a complaint look like?" Scornfully, Miller decided to answer this question not in words, but by action. He came to class one day dressed as a robot. His message, of course, was that it takes no great intellect or skill to draft a complaint.

Today, in the franchise context, there is a similar question: "How difficult is it to produce the documents—a Franchise Agreement, a Franchise Disclosure Document (FDD) and an Operations Manual (collectively, the Franchise Documents) necessary for a business to become a franchisor?

Often our clients think that the Franchise Documents can be prepared using a cookie cutter approach. That is, they are all basically the same and can be produced in the same way Henry Ford built cars—by making them essentially all the same except, perhaps, for the names of the parties, the name or the trademark, and the territorial grants and restrictions. Can you simply scratch out the words, "Five Guys" and put in the words, "Donald's Gourmet Hamburgers?" Putting aside issues of copyright law, the answer could be yes, and that suggests that the client may be able to prepare the documents him/herself without cost, or reduce costs significantly, or he/she can take the project to the low-price lawyer and have the documents prepared for a bargain price.

But is this a wise decision? I have in my inventory three examples where this is exactly what happened. These incidents all occurred in pre-spellcheck days, and in each case the person who prepared the documents accidentally did not change the name of the franchise to its own in at least one spot, and this error was overlooked by the drafter. With today's technology, and particularly spellcheck programs, this would be inexcusable.

Nevertheless, while Franchise Documents can be easily prepared by copycatting existing documents used by other franchisors, this overlooks the fact that this cookie-cutter approach is not likely to be successful when the franchise systems are not virtually identical. Copycatting will be less effective when the franchise systems are in different industries. One should not use a "go-by" (i.e., a document that is used as the starting point in drafting Franchise Documents (Go-By)) that was designed for a hamburger chain when preparing a service industry Franchise Document. But even if the draft based on the Go-By avoids this minefield because of the similarity of the two systems, there are other reasons not to use a copycat approach.

Exploring the Reasons

First of all, there are pragmatic reasons why not to follow this course. One pragmatic reason is that the Go-Bys may not be well-prepared, well-thought-out documents to begin with. Was the person who prepared the Go-By Franchise Documents a competent lawyer, and, of equal if not greater importance, was he or she truly familiar with the laws and customs of franchising. This may not be easy to determine, but if one can ascertain who was the lawyer who prepared the initial Go-By, one might ask him or her: Where should the FDD be filed in order to comply with the FTC Franchise Rule?

That's an easy question for a franchise lawyer to answer. A more challenging one is: Can the franchisor make financial performance representations (formerly referred to as "earnings claims") outside of the FDD? Answer: yes, but only in a very limited set of circumstances. But often the original drafter of the Go-

By cannot be determined or located, and it is also often the case that some Go-Buys have been based upon other Go-Bys so that prior defects have been handed down from one inadequate Go-By to another, thereby perpetuating already existing problems.

A second reason is that there are different philosophies applicable to drafting Franchise Documents, especially the Franchise Agreement. Some of the earliest Franchise Agreements (e.g., KFC, Dairy Queen) were one-page documents. Today, franchise agreements can run up to 50 or 60 pages, although a more typical length might be more in the 20-to-30-page range. Is simplicity or complexity the best route to follow? Lawyers often vote for complexity because they believe this will give their clients more protection. In contrast, clients, and particularly their sales team, prefer simplicity. Clients frequently complain, and rightly so, that prospective franchisees will not read an excessively lengthy document, particular when the expected investment in the franchise is low.

A prospective franchisee opening up a multimillion dollar hotel is more likely to have documents reviewed by a well-established commercial lawyer, while an immigrant buying a janitorial cleaning franchise, investing under $20,000, may be likely not to involve a lawyer at all. They may ask themselves: What good can be accomplished by bringing a lawyer into the investment process when the franchisor has already indicated that it is not going to negotiate changes to the documents? But the less sophisticated investors may not comprehend the nuances of the Franchise Agreement, such as: Who pays the costs to change out the trademark if the franchisor decides to do so? Or, can the franchisee continue in the same line of business if the Franchise Agreement is terminated?

Another problem in using a Go-By is that franchise systems are not all alike, as we assumed above. Training obligations, how marketing and advertising are handled, the scope of territorial assistance, what services the franchisor will provide, and many other aspects of the franchise system, may vary considerably among franchisors, even those in the same industry. And the more complicated the franchise may be, the greater will be the need for more changes to a Go-By.

It must be tailored to the pragmatics of the industry as well as to the way the franchisor operates in that particular industry. This requires more creativity and originality in drafting the Franchise Agreement. For example, some restaurant Franchise Agreements contemplate that the franchised unit will be free-standing; others contemplate that the premises for the business will be leased by the franchisee and located in a strip mall. Differences such as these mean substantial changes will be necessary to the Go-Bys to adjust to the client's particular business model.

Fourth, the law and business environment changes. Concentrate on the subject of technology for a moment. In 1975, the most complicated business devices used in a franchise might be a four-function calculator and an electronic cash register. Today, franchisees will need to buy much more difficult-to-use computers that must be synced with the franchisor's computer system and operated under strict directives issued by the franchisor. A franchise agreement from the 1970s will not say anything about social media and perhaps may also say nothing about national advertising funds or a requirement that franchisees join local advertising co-ops. The passage of time changes life.

As for changes in the law, there have been many. Franchise Agreements created in the 1970s will not mention a franchisee's obligation to comply with anti-terrorism laws. Or the agreement might say that the franchisee is totally free to set the prices at which the franchisees offer to sell the franchisor's products or services. This may not be the desired approach for the franchisor's business model in light of the dramatic changes to the law and opportunities relating to vertical price-fixing resulting from the decisions in *Leegin*[1] and *Khan*.[2] These cases reset the rules with respect to minimum and maximum vertical price-fixing. And the laws governing data protection, privacy, and joint employer liability are all areas in a state of flux. Just five or 10 years ago, there were minimal, if any, words in a Franchise Agreement addressing these issues.

And finally, franchise agreements not only cover rights and obligations, but how disputes between the franchisor and its franchisees will resolve their differences. Thirty years ago, few Franchise Agreements would contain mandatory arbitration clauses; today, probably more than half do. Why? Because the law here, too, has changed. While many franchisor lawyers have historically had mixed views toward the desirability of arbitration, the most recent decisions by the U.S. Supreme Court have put a finger on the franchisor's side of the scale, changing what was once promoted as being a fair, cheaper, more balanced approach to resolving franchise disputes into a more franchisor-friendly process.

Other Documents

The focus of this article has been on the Franchise Agreement, and little has been said about the other Franchise Documents, that is, the Operations Manual and the FDD. However, there are also problems and considerations with the preparation of either of these documents that make use of the cookie cutter approach questionable. Since the FDD contains many items, the language of which is dictated by the rules promulgated by the Federal Trade Commission and state laws governing franchise sales, the cookie cutter approach might work better here than it would with respect to a Franchise Agreement.

On the other hand, for the Operations Manual, there are no governmental guidelines controlling their content. Hence, it is more likely that there will be greater differences in the scope of issues covered, as well as how those items are applied in various franchise systems. Consequently, a significant amount of original drafting may be needed before the document should be acceptable to the client. Will the cookie cutter, low-cost Franchise Documents address this challenge?

Franchise Legal Services

To be clear, this article is not intended to suggest that lawyers who charge lower prices for Franchise Documents are selling inferior legal products. It is meant to say that the value of the services of lawyers provided to clients in the franchise sector will depend upon more than just how inexpensively Franchise Documents can be prepared. How much more will it cost to prepare documents that will require significant changes to the preparation of a Franchise Document as compared to the cost to manufacture a cookie cutter product? One must add to this analysis what is the value of the experience and knowledge of the franchise lawyer to the price that should be paid for franchise legal services.

When looking at this situation existentially, a higher price for more valuable legal services may well be worth the increased cost, rather than using a lawyer that is working almost exclusively from a template. In fact, the cost of paying more for creation of Franchise Documents may be more palatable when it is recognized that the sale of one, two or three franchises will likely cover the additional costs.

Admittedly, businesses should always be cost-conscious, but choosing the provider of franchise legal services is not the place to cut costs solely on the basis of prices charged by legal providers. Mercedes and Ford Escorts are both cars, but they are two quite different vehicles. So, too, Franchise Documents prepared on the cheap, and without additional advice on franchising, may be a far different animal than Franchise Documents that have been prepared by a lawyer who is both familiar with these types of documents and who can provide the legal advice necessary to develop a successful franchise system when the value of experience and expertise is added into the calculation.

Endnotes:

1. *Leegin Creative Leather Products v. PSKS*, 551 U.S. 877 (2007). This case ruled that vertical minimum price-fixing would be judged under a rule of reason test, rather than a per se one.

2. *State Oil Co. v Khan*, 522 U.S. 3 (1997). This case held that vertical maximum price-fixing would be judged under a rule of reason test, rather than a per se one.

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