

FRANCHISE ATTORNEYS SPEAK OUT ABOUT AAHOA'S 12 POINTS

Point 2: Impact/Encroachment/Cross Brand Protection.

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The issue of Impact, Encroachment, and Cross Brand Protection or Area of Protection (AOP), generally includes restricting the franchisor from licensing additional franchisees within a certain geographic distance from the franchisee's hotel. This can take the form of an additional hotel with the same flag, or a different flag *operated by the franchisor, whether presently existing or to be created or acquired in the future.* This article addresses some of the key issues a franchisee should consider during the negotiation of a franchise agreement.

As with most issues regarding the franchise relationship, without state statutory protections, of which there are very few, the provisions of the contract determine the rights of the parties. This is especially true in regard to the franchisee's area of protection.

STATUTORY SCHEMES ADDRESSING AREA OF PROTECTION

Two states (Iowa, Hawaii) have statutes limiting encroachment on the territorial rights of a franchisee. Even those laws provide only minimal protection from encroachment. Iowa's law, the most franchisee friendly, enables a franchisor to avoid violation if the franchisee has (1) a right of first refusal with respect to the proposed new location, or (2) a right to compensation for market share diverted by the new outlet. In the second situation, the franchisor can comply by implementing an impact policy and procedure by which the parties determine if a substantial impact affecting the franchisee's profits exists.

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NEGOTIATING THE FRANCHISE AGREEMENT – THE IMPORTANCE OF EXPRESSLY DEFINING AOP

The majority of court decisions hold that the franchise agreement is determinative on issues of AOP. For a franchisee desiring to protect his investment, seeking as much express written language defining the AOP is essential.

If a franchisor encroaches a franchisee's AOP, without express language in the franchise agreement defining the AOP, a franchisee's only protection is the implied covenant of good faith and fair dealing. Two problems exist with this approach: (1) if the agreement has no express territorial exclusivity language, the recent trend among most courts is to not read such exclusivity into the contract as though it existed, and (2) many recent franchise agreements attempt to limit the scope of the implied covenant of good and fair dealing by inserting technical definitions that substantially limit the expectations of the parties. Although courts will not enforce provisions where the franchisee completely waives the implied covenant, contractual provisions that limit the expectations of the parties cut at the very heart of its usefulness. These recent provisions have yet to be tested in the courts, but they may very well be upheld.

EXPRESS AREA OF PROTECTION PROVISIONS – ISSUES TO CONSIDER

Franchisors are not all the same. Often the most successful and mature brands are less likely to grant wide-ranging areas of protection. Conversely, emerging and expanding brands are often more



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accommodating in their desire to secure a franchise for a specific location or region. A prospective franchisee needs to compare the benefits offered by the mature franchisor's brand identification and reservation contribution to the more extensive AOP offered by less developed brands. Sometimes even a mature franchisor will be more conciliatory to a newly developed hotel because it improves the overall quality of the franchisor's hotel offerings. Regardless of which franchise you seek to license, always seek to achieve some protections in the following areas.

- Request an exclusive territory as large as you think you need given the supply and demand market dynamics in the area. Keep in mind that urban areas will be more narrowly defined.

- Even if the franchisor initially objects to providing an AOP for the full term of the franchise, seek an AOP for a portion of the term.

- If the franchisor has existing properties in your market, seek to limit future development of additional hotels, and expansion of existing hotels. This is particularly important if the franchisor's other

flags in your market are closely competitive with your property.

- In seeking to limit the franchisor's addition of new properties, try to have the limitation apply to flags to be created or acquired in the future.

- Always obtain a copy of the franchisor's impact policy and review it carefully to understand the parameters by which a substantial impact will be determined.

- At a minimum, condition additional franchisees within your market on the results of an impact study conducted by a neutral third party.

FINAL THOUGHTS

AOP provisions are just one of many important provisions in a franchise agreement. Professional advisors with specialized experience can obtain compromises on AOP and other issues. At a minimum, you will understand the risks of your agreement. The cost is

negligible compared to the risk and the amount of expenditure during the term of the agreement.

At present, only your agreement protects you. The law does not. The long term interests of the association's membership can be furthered by legislation that levels the playing field. We encourage you to support AAHOA's Political Action Committee (PAC) to secure laws that better protect your interests.

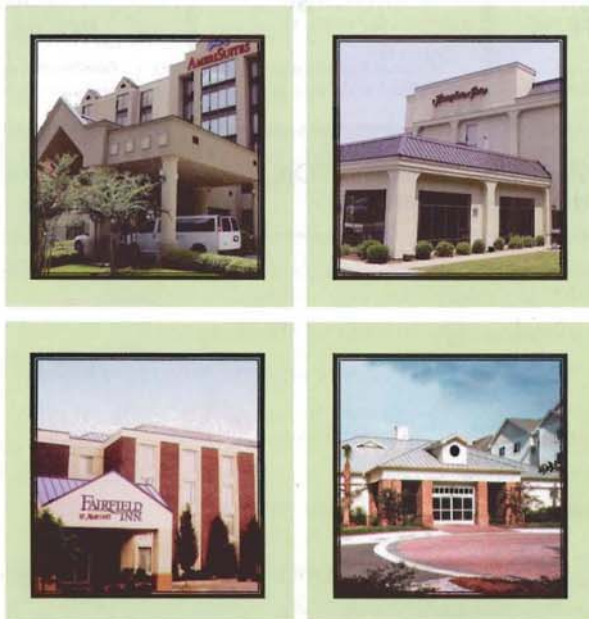
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The information presented in this article is general in nature. Nothing in this article is intended to provide specific legal advice. Please contact your franchise counsel or other counsel if you have any particular issues that require attention.

To review
AAHOA's 12 Points
of Fair Franchising
and AAHOA's
commentary
on each point,
please visit:

[http://www.aahoa.com/
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