



FIVE BEST PRACTICES FOR FRANCHISORS TO THRIVE AMID GAME-CHANGING FRANCHISE LAW DEVELOPMENTS

Franchising is facing external forces that could threaten the franchise business model as we know it today. Those forces include the NLRB's efforts to deem franchisors joint employers of franchisees' employees, an increasing number of vicarious liability related lawsuits and other recent developments.

Franchisors and franchisees have vested and aligned interests in confronting these external forces. These forces also present opportunities for franchisors to reinforce and balance the roles and responsibilities of the franchisor, franchisee and system as a whole. Our Faegre Baker Daniels franchise practice has prepared the following best practices to assist franchisors in those efforts.

ONE ▷ UNDERSTAND THE FUNDAMENTALS OF FRANCHISING.

Defeating claims of joint employment and vicarious liability turns, in part, on understanding and explaining the fundamentals of franchising. A business format franchisor does not just license a trademark, it provides its franchisees with an entire method of doing business that is defined and controlled by system standards. These system standards also drive uniformity so that one franchised location is indistinguishable from another.

In many respects, system standards are about controls. To the uneducated, these controls may appear pervasive. But each control exercised or retained by a legitimate franchisor serves a function other than controlling a franchisee's day-to-day operations. The key is to recognize, understand and distinguish the nature and scope of the controls as further described in Best Practice Two.

Franchisors win cases where the court, jury or arbitrator understands that common franchisor controls empower independent business persons to fulfill the "American Dream" of operating their own successful business. This same message also should be shared with regulators and lawmakers.

TWO ▷ BE DELIBERATE IN REQUIREMENTS AND RECOMMENDATIONS.

Customers and employees of franchisees frequently sue the franchisor for the actions of the franchisee or the franchisee's employees. Plaintiffs argue that the franchisor should be responsible for the actions of the franchisee or the franchisee's employees because of the franchisor's controls. Courts may not look kindly on franchisor requirements that extend far beyond protecting the system and trademarks. In order to minimize this risk, evaluate whether current requirements or those capable of being imposed on your franchisees are truly necessary or merely a suggestion. Understand the difference between mandating system standards versus unnecessarily mandating the manner and means of meeting the standards. It is often more appropriate to identify guidelines, recommendations or best practices to meet the standards. Do not let tradition keep you from making changes (i.e. "That's not the way we've done it in the past."). Also confirm that your franchise agreement and operations manual explain the difference between requirements and recommendations.

THREE ▷ EDUCATE YOUR FIELD STAFF ON THE FRANCHISOR-FRANCHISEE RELATIONSHIP.

Your field staff should be passionate about helping your franchisees succeed and grow their businesses. But your field staff also need to conduct themselves with an understanding that each franchisee is an independent contractor who has control over its day-to-day operations, that the franchisee is not an agent of the franchisor, and that the franchisee acknowledges that it is ultimately responsible for all aspects of its business operations.

Make sure your field staff understand that they should not get involved in a franchisee's HR-related matters. They should also understand the difference between training provided to a franchisee and the franchisee's obligations to train its employees. Your field staff must know when their passion for helping franchisees could be distorted into excessive control of franchisees. Provide them with appropriate and ongoing training, guidelines and best practices to enable them to effectively fulfill the key roles they play.

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FOUR ▷ ACKNOWLEDGE THAT FRANCHISEES OPERATE INDEPENDENT BUSINESSES.

Franchisors and franchisees both want franchisees to operate independent businesses as part of a franchise network and key stakeholders in the brand. Indeed, every year you probably hear from franchisees who exclaim that they are independent owners. Follow through on this key principle as it will matter when confronting these external forces. Make sure that the franchisee conspicuously identifies itself and its business as an independent franchise owner in all dealings with clients, customers, suppliers and others. This can include appropriate statements on signage at the business, your website, customer order forms and other related items.

On issues unrelated to protecting the system or trademarks, embrace your franchisees' desire to operate independent businesses as part of a network. Also, encourage your franchisees to remind their employees, customers, lawmakers and communities that they are independently operated.

Franchisors can best manage their risk when franchisees operate independent businesses as part of a franchise system that has appropriate system standards to protect the brand. This begins with the franchise development process and initial training, as you reinforce the roles and responsibilities of the franchisor and franchisee. When done properly, franchisees are fully engaged and you and your franchisees can focus on effective collaboration on customer-centric initiatives and activities that reinforce an undying devotion to the brand.

Effective collaboration also fosters a willingness to embrace system change and other best practices that are necessary to drive unit-level economics and a franchise system's sustainability.

FIVE ▷ UTILIZE THE FRANCHISE AGREEMENT AND OPERATIONS MANUAL TO PROTECT THE SYSTEM AND APPROPRIATELY DEFINE THE ROLES AND RESPONSIBILITIES OF THE PARTIES.

Franchisors rightly impose requirements and system standards to assure uniformity in the franchise system and protect their trademarks. Those fundamental requirements should not be twisted by courts to impose liability on the franchisor for wrongdoing by the franchisee or the franchisee's employees

To minimize this risk, the franchise agreement should expressly declare that any required standards exist to protect the franchisor's interests in the system and the trademarks and not for the purpose of establishing any control or duty to take control over those matters that are reserved to the franchisee. Your franchise agreement should reiterate within particular subject areas such as employment, technology, training and elsewhere, that any particular standard is not intended to exercise control and that the franchisee is responsible for such control.

The franchisor's operations manual should appropriately balance the roles and responsibilities of the franchisor and franchisee. The franchisor's role is to protect, grow, and evolve the brand and system. The franchisee is responsible for the day-to-day operation of the business. The operations manual reinforces the nature and scope of controls, as well as distinguishing the difference between required system standards and recommendations, guidelines and best practices to achieve those standards.

Take a look at the supplementary piece we have prepared on language to consider for your operations manual as well as provisions you may want to include in your franchise agreement.

QUESTIONS ABOUT RECENT FRANCHISE LAW DEVELOPMENTS?

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