

# **FORMING AN INDEPENDENT FRANCHISEE ASSOCIATION**

## **I. INTRODUCTION**

### **A. What is an Independent Franchisee Association**

An “Independent Franchisee Association” is an organization of Franchisees, in most instances from a single franchise system. Its typical functions include: providing a single, more powerful voice for dealing with the franchisor; providing educational resources for the franchisees; facilitating communication among franchisees; and enhancing its members’ purchasing power. In other words, an Association creates a platform in which the whole is stronger than its parts.

The particular structure of the Association can vary depending on the size of the system. In a typical franchise system, the franchisees create the Association and are its members. In larger, or geographically expansive systems, there may be regional associations, which together form a national association. Regardless of the structure, the purpose of the Association tends to be providing the basic functions mentioned above.

An “Independent” Association is distinguished from advisory councils or other organizations created, organized or funded by the franchisor. These hybrid associations can be useful and constructive tools, but the ability for independent action to benefit the franchisees is often compromised by the franchisor’s influence and control.

### **B. Why Form an Independent Franchisee Association**

#### **1. Creating Win-Win Situations**

The best use of an Association is to create win-win situations through better communication and understanding. With just two parties talking (i.e., the franchisor and an association representing the franchisees), it is much easier for each side to understand and appreciate the other’s positions. Better communication and understanding unquestionably make win-win results a much more likely outcome.

Likewise, an Association creates a stage for the franchisees to discuss and debate the issues they face. This allows them to make more informed and better-understood decisions. This in turn leads to better, more well reasoned positions, that are more likely to receive a favorable reception from the franchisor.

#### **2. Education**

Associations also provide a great educational resource for franchisees to improve their businesses: successful franchisees in a system are an excellent source of information and knowledge for a struggling or new franchisee. Yet this superb resource is often

overlooked or hard to access. An Association is a perfect tool for setting up and hosting educational programs at which successful franchisees can advise other franchisees needing assistance.

Likewise, Associations can be a great resource for general education. Instead of each franchisee spending valuable resources investigating the best new technologies or business practices, an association can research this for the entire system. This creates an economy of scale that greatly reduces the time and energy individual franchisees have to put into learning the newest and best technical advances for their system. Thus, instead of spending time trying to figure out how to keep ahead of the competition, they can spend time actually doing it.

### **3. Buying Power**

In some systems, franchisees can greatly increase their buying power by creating national or regional purchasing cooperatives to negotiate lower prices for goods and distribution agreements. Thus an Association can increase its members' profit margins by lowering their operating costs.

### **4. Leveling the Playing Field**

One of the most compelling reasons for forming an Independent Franchisee Association is that it can help level the playing field between the franchisor and its franchisees. Of course conflict with the franchisor is hopefully a last resort, but in some instances it cannot be avoided. Almost all franchise agreements are adhesion (take it or leave it) contracts, with one-sided terms designed to overwhelmingly favor the franchisor. In addition, only about half of the states have franchise laws that provide any special protections for franchisees, and even these are generally limited. Thus, from a legal standpoint, the odds are almost always stacked in favor of the franchisor. Consequently, a typical franchisor tends to have exclusive control over its system and to dictate the way in which it is run without input from the Franchisees. There is therefore a potential for abuse by the franchisor in almost every system.

Likewise, franchisors are usually more sophisticated and have considerably more financial power than their franchisees. Except for some large multi-unit operators, franchisees are more often than not single owners, family businesses or small partnerships. These typical franchisees often don't have the time, leverage, financial wherewithal, or sophistication to meaningfully negotiate with their franchisor. This can result in a daunting situation where the franchisee's life investment is at risk but they cannot afford to do battle with the franchisor and its high priced lawyers. The result is that even though the Franchisor might not have the stronger legal position, it often has the means to wear down the franchisee by simply outspending or out-litigating it. In short, most franchisees come into every interaction with the franchisor as a David facing Goliath.

An Independent Franchisee Association helps level the playing field by maximizing the franchisees' bargaining power and giving them substantially more leverage in negotiations. This significantly increases the potential for positive results. For instance, a single franchisee by itself cannot generally match a franchisor's budget – but when the whole system pools its resources, the disparity is greatly reduced. Even a protracted legal battle is easier to stomach when each franchisee is paying just a small percentage of the bill.

Similarly, speaking with one collective voice is generally much more effective: First, it centers the issues by narrowing their focus. Unless the franchisees' position is clear, legally supported, or put forward with some type of leverage, they will not generally receive a favorable response from the franchisor. Second, a collective voice shows the franchisor that the issue has broad support and it is not just dealing with a squeaky wheel. A franchisor approached by single franchisee or even a small percentage of the system is not likely to be receptive to any significant changes. Indeed, it may be tempted to squash the effort as an example. This is especially true when the rest of the system is silent. On the other hand, when the franchisees reach an organized consensus, it is much more difficult for the franchisor to ignore well-stated demands.

To appreciate the need for a level playing field, it is important to understand why franchisors take positions that are at odds with their franchisees. It is basically because a franchisor's business interests tend to differ from the interests of its franchisees – or at least many franchisors perceive that they do. In particular, the main goal of a franchisor – to maximize its profits – can sometimes be achieved at the expense of its franchisees. This happens when the franchisor raises fees in its royalty structure, increases the wholesale costs of its required proprietary goods, or places a second franchisee within an existing franchisee's territory. These situations can significantly reduce individual franchisee's profit margins, but increase the royalties, profits and franchise fees received by the franchisor.

Franchisors' strategies which reduce franchisees' income are often rather shortsighted. Together, the franchisor and franchisees are generally better served by a long-term plan that maximizes profits for both. A business plan that benefits the system as a whole is almost always a better strategy than one that simply provides a short-term profit for the franchisor. Unfortunately, franchisors are not always far-sighted enough to follow this model. This is especially true when the franchisor is looking to sell, has recently purchased the system, or is trying to attract investors. Thus, Franchisees are often faced with a franchisor trying to maximize its profits at their expense.

Each franchise system is similar in that it involves franchises. Thus, Independent Franchisee Associations, regardless of the particularities of their systems, will find they face many similar issues. On the other hand, because of the vast spectrum filled by modern day franchising, the products and services offered vary significantly. While an Association will find it has many of the issues listed here in common with other associations, it will also find it necessary to tailor itself to the specific needs of its

members and their system. The common thread however, is that by forming an association, the whole is made stronger than its parts.

## **II. FORMING THE ASSOCIATION**

The key to forming a successful Association is attaining the highest possible participation level. Attracting members is paramount. On the same note, commitment is also extremely important. It is imperative to begin with and attract committed individuals who will see the Association through to the end. The third key to forming a successful association is avoiding negative confrontation with the franchisor. Formation should be approached as a positive action that is not intended to threaten the franchisor. While the franchisor should not have control of, membership in, or significant influence over the Association, it should be included to the extent that the association is not perceived as a negative concept.

### **A. Where to begin**

Most Independent Franchisee Associations begin with a few committed franchisees. Thus, the first thing to do is start talking and find out who else is interested. Even without an Association, franchisees are almost always talking about issues facing their system. These connections between franchisees are the best place to start. Even absent any connection, it is often known in a system which franchisees have been discussing issues with the franchisor – start with them. If there is not a base of franchisees discussing issues, then go to the next level and try cold-contacts. Begin by discussing issues that you perceive as common concerns throughout the system. If there is interest, then raise the idea of an Association. It is best to keep in mind that the franchisor may not initially see the Association as positive development. If there is any chance of retaliation, it is probably best to keep these initial contacts as low-key as possible. Franchisors often provide an Internet bulletin board for franchisee communications. If you think the franchisor will object to the formation of an Association, it is best not use the bulletin board as an organizing forum.

#### **1. Planning and Strategy Meetings**

Once a group of interested franchisees is identified, the next step is to hold a series of planning and strategy meetings. There is no set number of organizers or meetings a particular Association may require. This will vary depending upon the system, the potential size of the Association, and numerous other factors. The organizers' commitment, however, is key. Unless the organizers are dedicated to the cause, the Association is bound to fail.

These meetings should typically start out with an informal planning session and progress to more decision based gatherings. Some face-to-face meetings are probably necessary, but much can be accomplished by conference calls. The general purpose is to discuss the issues facing the system and create a general plan for the Association. In

other words, to decide on a set of initial goals and a strategy to meet them. Of course, the system need not be faced with any critical issues requiring immediate action. Associations are often formed merely to address the general concerns described above such as education and expanding or coordinating communications. However, as noted, one of the essential goals should be attaining maximum franchisee participation. Identifying important issues in a system, and communicating them is often the key to attracting members.

The organizers should also determine the structure of the Association. Generally it is best to set up a structure that treats all members fairly. Dues, membership requirements, and voting power should be fundamentally equal. This does not mean they must be identical. For instance, in some systems, it makes sense to use a graduated structure for dues in which multi-unit owners pay more than single unit owners. The basic formula, however, must be perceived as fair. There can also be different levels of membership. For instance, full members who pay more dues and receive more benefits, and associate members who pay less dues and receive less benefits. Systems which involve the sale of goods often allow vendors to purchase non-voting associate memberships, which provides an additional source of revenue for the Association. Regardless of the particulars, the key is to create a system that is perceived as fair.

The other key factor mentioned above is commitment, not only of personal time and energy, but also of money. The organizers should also use these preliminary meetings to determine how to pay for the initial start-up costs. Typically, the organizers pitch in and pay these costs themselves. This can be done on an equal basis or based on the size of the particular franchisee. Generally, however, unless there are extraordinary circumstances, the total amount is relatively small. The start-up costs are generally limited to hiring a lawyer to create a corporation or other legal entity and the costs of the initial membership drive. Assuming the Association successfully attracts members, these start-up costs may be repaid once the dues start coming in.

There is no set limit to the number of preliminary planning and strategy meetings. This will necessarily depend on the varying circumstances and potential issues facing the particular system. The organizers should, however, do their best to remain focused and to keep moving forward. If a consensus is not being reached, and the meetings start to drag on without much development, interest may dwindle. If this starts to happen, it may be helpful to bring in an outside advisor to help get things back on track.

## **2. Hiring a Lawyer and Creating a Legal Entity**

At some point in the process, the organizers need to consider the legal questions that the franchisees and the Association will face. This is typically done by hiring a lawyer to advise the group. Depending on the circumstances, the organizers may do this before or during the initial planning phase, but at any rate, should do it before the organizational meeting discussed below. As a general rule, the sooner the Association gets competent advice from a lawyer experienced with Franchisee Associations, the better. By bringing in an advisor early the organizers can avoid repeating others'

mistakes or re-inventing the wheel, which usually saves substantial time and money. In addition to legal advice, an experienced franchise attorney can often provide valuable strategic advice as well.

In addition to providing guidance on many of the issues already discussed here, an attorney is typically needed to help create the legal entity that is the Association. Each state has different entity structures, but in most cases, corporations or limited liability companies (LLC) are used. The attorney advises the organizers as to which specific entity best fits their needs, and then prepares and files all of the necessary documents to create the entity.

Another reason for bringing in an attorney is to create a wall of confidentiality between the Association and the franchisor. Ultimately, there will be issues and discussions that the Association wants to keep private from the franchisor, which may not be possible without an attorney. If the Association or individual franchisees find themselves in litigation with the franchisor, they may be forced to disclose their private discussions in discovery. If an attorney is involved in the discussions, these discussions can usually be kept confidential under the attorney-client privilege doctrine.

### **3. Organizational Meeting**

Once a legal entity has been created, the organizers should then hold an organizational meeting. Among other things, the meeting should be used to complete the formalities that go along with being a legal entity. For instance, adopting Bylaws or a Membership Agreement. These are typically prepared by the attorney based on discussions with the organizers, and presented at the meeting for approval. Because approval is usually accomplished at the meeting, it is a good idea to disseminate the bylaws prior to the meeting with a sufficient time for review. Usually this is done during the planning stage discussed above. By the time of the organizational meeting the details should have been decided, so that all that is left to do is ratify and adopt the operating procedures.

The organizational meeting is also used to elect officers and directors (or managers if an LLC). This is an important step and again raises the extremely important concept of commitment. It is of the utmost importance to select a group of key franchisees who are strongly committed to the Association's purpose and the causes it will address. This commitment, or lack thereof, is often what makes or breaks a successful Association.

### **III. RUNNING THE ASSOCIATION**

Once the association is up and running, the next steps are to start signing up members and conducting daily operations.

#### **A. Membership Drive**

A successful membership drive usually depends on the people organizing it. Thus the commitment of the persons running the Association is again paramount to its success.

The type of membership drive will naturally depend on the specific system, and the nature of the issues which motivated the formation of the Association. Often, the best method is for the directors and organizers to directly contact other franchisees with whom they already have a relationship. Even if there is no preexisting relationship, telephoning or meeting in person is usually the best method. It allows the prospective member to explain the various issues with which he or she is concerned and also allows the Association to respond and explain how it will help the individual franchisee. A letter or e-mail usually just highlights a few important issues, and if it is too detailed, it may be thrown away unread. Of course in a larger system, direct contact may not be practical in every case, so e-mail and letters may be the only feasible means. Other options are websites and publicity (e.g., press releases, system-wide newsletters, etc.). The key, however, is to get the information out in an attractive way that will make franchisees want to join the Association.

#### **B. Presenting the Association to the Franchisor**

The membership drive may also be the moment when the franchisor becomes aware of the Association. Again, it is essential to present the Association to the franchisor as a positive development. Of course most franchisors will already have opinions about the purposes behind an Independent Franchisee Association. Thus, there may be preconceptions, which can be either positive or negative. If negative, it is often most productive to assure the franchisor, through open and frank communications, that the purpose of the Association is to narrow issues and alleviate potential disputes between franchisor and franchisees. Also, explain that the Association will allow the franchisor to deal with one voice rather than the multitude of individual franchisees. In some situations, inviting the franchisor to attend and participate in certain membership meetings may gain the franchisor's acceptance. Being offered a forum to address the whole system is usually a very attractive offer. However, it is important to remember that franchisor participation must be sufficiently limited so that the independence of the Association is never compromised.

Some Associations, on the other hand, are formed because of existing issues and potential legal battles. In these instances it may be futile or even unproductive to involve the franchisor. While individuals are guaranteed certain rights to associate under the U.S. and most State Constitutions, and some State franchise laws specifically authorize franchisee associations, these don't necessarily protect franchisees from a hostile

franchisor bent on stopping an Association before it gets started. It is not uncommon for a franchisor to threaten and retaliate against individual franchisees who attempt to form Independent Franchisee Associations, so a more stealthily approach may be warranted in these situations. Because of the legal and potentially detrimental business implications, these situations should almost always be handled with the advice and assistance of a competent franchise attorney.

### **C. Membership and Directors' Meetings**

Membership meetings are an integral part of a successful association. These meetings provide the forums that allow members to give the Association its direction. Participation in the Association and a feeling of control are important aspects which keep members interested and committed to their memberships. If members feel disassociated or that the Association is not meeting their needs, they will leave.

The appropriate number of membership meetings each year will vary depending on the needs of the particular Association. There should, however, be at least one meeting each year. In systems with pressing issues, quarterly meetings may be appropriate. The Association can also call special meetings when particular issues needing attention arise.

The appropriate number of Directors meetings will also vary with the needs of the particular Association. In addition, the state in which the Association is organized will generally require a set minimum number of Directors' meetings. In most states it is at least one meeting per year. Generally, however, the directors will want to meet more often – at least quarterly and maybe even monthly. These meetings can usually be done by teleconference.

### **D. Become Active**

An active Association is one of the surer means for keeping continued interest and membership alive. Likewise, active Associations tend to achieve more positive results. The directors often play the lead role in maintaining an active Association, but involving members can greatly increase membership totals and the effectiveness of the Association.

One of the best ways to get members interested is by forming committees. This gets them involved with the Association's direction and helps them to feel a part of the process. It also insures that the Association is actually meeting its members' needs by including more direct member input. In the end, it also improves the ability of the Association to reach a narrower focus on the various issues it and its members will address.

### **E. Daily Operations**

Once an Association is large enough, it may consider hiring management to run its daily operations. Depending on the size of the Association, this may be a single

manager or a full staff of employees. There are also management companies that specialize in running business associations.

#### **F. Attract Vendors / Support**

Most Associations are funded through member contributions and dues. There are, however, other sources that may provide significant revenue streams. Particularly, in systems that rely on outside vendors and suppliers, advertising can be a huge revenue resource. Vendors will often agree to sponsor Association events such as the annual membership meeting or convention. Likewise, vendors will usually jump at the chance to advertise in publications or newsletters that reach an entire system.

This overview of an Independent Franchisee Association is intended to provide a very general background on how to start the Association, how to attract its members and how to run it once it is operational. Because franchise systems vary, sometimes significantly, this guide should not be used as strict rulebook that is the be all and end all of how to start and run an Independent Franchisee Association. In order to form your Association it is important to seek competent legal advice from an attorney experienced in franchise law and preferably with a background in forming Franchisee Associations. This will significantly improve the Association's chances of getting off the ground and moving it forward in a direction that will best benefit the system's franchisees.

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