Franchising and Technology:  
Staying Current and Managing Change

Lorinda Church  
FranchiseSource Brands International

Nancy Ghanem  
FDDPlus.com

Dominic Mochrie  
Osler, Hoskin & Harcourt LLP

Lee Plave  
Plave Koch PLC

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I. INTRODUCTION

Businesses must evolve to stay competitive and thrive, and franchise businesses are no exception. Franchisors attempting to evolve and change their systems face unique challenges. Franchisors are faced, somewhat paradoxically, with the challenge of continually ensuring compliance with system standards by franchisees while at the same time introducing new standards that are necessary to evolve the system. System standards in a healthy franchise system are not static; they are more accurately described as being in a dynamic equilibrium where new standards supersede old standards.

This paper presents tips, traps and best practices for how to deal with the intersection of franchising and technology. Specifically, this paper addresses four key issues relating to franchising and technology:

- Cloud computing and franchising: Achieving security, privacy, reliability and control;
- Keeping up with ongoing changes in electronic listings, directories and social media resources;
- Business and legal issues raised when rolling out new software or other technology mid-term; and
- Tips and traps when using e-disclosure, including compliance with the FTC Rule.

This paper does not summarize all of the cases that have dealt with these topics (each of which could be the subject of its own paper), but instead proposes some best practices that should be taken from the principles of those cases and from the authors’ experience assisting clients with these matters.
II. CLOUD COMPUTING AND FRANCHISING:

ACHIEVING SECURITY, PRIVACY, RELIABILITY AND CONTROL

A. WHAT IS CLOUD COMPUTING?

“Cloud computing” has become a recent buzzword, appearing with increasing frequency in general and industry media. Is this new technology and does it revolutionize computing? Are those who do not adopt it doomed to draft disclosure documents on a Commodore 64?

In truth, cloud computing is not a new concept; rather, it is a new name for evolving technology that was previously known as remotely accessing software through application service providers. The concept of cloud computing dates back to the 1960s, when John McCarthy opined that “computation may someday be organized as a public utility.”

Simply put, cloud computing is a model in which information and software is not stored on each user’s computer terminal; rather, each terminal is connected to a remote server via the Internet, and that remote server hosts all of the applications, data, and software that the user accesses. The user’s computer only needs to have a reliable Internet connection and run the interface, which is often a web browser (such as Microsoft’s “Internet Explorer,” Mozilla’s “Firefox,” and Google’s “Chrome” browsers) to access the server. A simple example of cloud computing can be found in many law firms’ remote access systems, which use a virtual private network (VPN) or Remote Desktop Connection software; other examples include e-mail accounts hosted by Google (Gmail), Yahoo, or Hotmail - where both the software required to operate the program and the information accessed through the software is housed somewhere other than the user’s computer, but is accessible via the Internet.

Gartner Group, the well-respected consultancy, attributed the rise in cloud computing to three factors: “commoditization and standardization of technologies, in part to virtualization and the rise of service-oriented software architectures, and most importantly, to the dramatic growth in popularity of the Internet.”

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B. CLOUD COMPUTING AND FRANCHISING

1. Types of Cloud Solutions for Franchisors

The kind of software solutions available through cloud computing are as varied as those run on local hard drives. Franchisors can take advantage of cloud computing for the franchisor's employees and for communications with franchisees and customers. In general, franchisors can consider the following categories of software solutions:

(a) Customers:

Customer Relationship Management: Cloud computing permits franchisors to manage customer relations more efficiently and synchronize business processes to allow for seamless interaction with customers. Cloud Computing allows franchisors to centralize customer information so that service representatives can efficiently access customer records and provide information to the consumer. Speed of access can reduce wait times and facilitate customer service, reducing customer-service department costs.

Customer Service Portal: Additionally, hosting a customer-facing portal in a cloud allows franchisors to elect to provide some access to customers and create self-service websites for their customers to track customer comments, post feedback, interact through social networking sites, and search the online knowledgebase to answer their own questions.

(b) Franchisees:

One challenge franchisors face when attempting to roll out new software among franchisees is the differences in speed, age and capacity of each franchisee's computer. One of the principal benefits of cloud computing, as noted above, is that the local user’s computer typically only needs an internet connection and basic web-browsing capability in order to use the hosted software. By providing solutions through cloud computing, the franchisor can make it easier for franchisees to run the same up-to-date software almost without regard to what local technical platform the franchisees are using. This method increases the likelihood that franchisees will run the most current and accurate software while reducing franchisees’ need for expensive computer upgrades. Functionally, this helps franchise systems sidestep many of the problems that have hindered the roll-out of technology in the past, among which are cost, inconsistent hardware and software platforms, and the sheer inconvenience of having to install new hardware and software – thus improving the likelihood of a successful implementation and widespread use of important software by the franchisee community.

2. Advantages of Cloud Computing

Some examples of the advantages of cloud computing for franchisors include:

- **Accounting**: Franchisors can create a standardized online accounting template for use by franchisees. This reduces the franchisor's burden to interpret different
recordkeeping methods and can eliminate manual data entry. Standard online templates also reduce inconsistencies in franchisee reporting and make it easier for the franchisor to spot anomalies or problems. Cloud accounting allows multiple users to have access to the same up-to-date financial information at the same time.

- **Franchisee Extranet**: Franchisors can create a franchise extranet to encourage communication among franchisees, franchisors and suppliers. The intranet reduces costs by eliminating multiple communication channels and allows franchisors to maintain a unified record of all communications.

- **Franchise History and File Storage**: Storing files in the cloud may save franchisors the cost of physical storage and may also improve access to stored files. Many cloud solutions have better search and index capability than local solutions, so that a franchisor can more easily search the entire library of documents at once.

Caution is appropriate though. Although an apparent advantage to cloud computing is that franchisors need not pay for additional file back-ups or retain physical backup copies (or media), that advantage is only as real as the security associated with the cloud solution in the first place. For example, franchisors may be vulnerable to data compromise or loss if the cloud solution is hosted by an insecure provider, or if the provider does not properly back-up its data files. Additionally, remote access to any computer system may be fatally compromised if the users do not take basic and adequate precautions, starting with the use of “strong” passwords and the physical security of remote access devices (such as smartphones, tablet computers, etc.).

- **Flexibility**: Because records stored in the cloud can easily be accessed remotely, the franchisor’s management team may enjoy more flexibility than if the records could only be accessed from within the franchisor’s offices. Among other things, this means that the management team may be able to work from a hotel or a franchisee’s office, may be able to work at different hours and from different locations (e.g., internationally or on a different coast), or may simply to be able to accommodate the vicissitudes of modern family life.

- **Reduced Upfront Cost of Software Acquisition/Reduced IT Staff**: Franchisors can avoid large upfront costs to purchasing software for each employee’s terminal. Rather than having to hire a staff to design applications, upload software, and install updates, the franchisor is likely to have the option to pay for cloud computing services through an ongoing monthly fee. Other savings can be

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achieved through efficiency of use – for example, with a centralized computer
system, administrators need only modify one version of the software hosted on
the server, and do not have to access and modify the software on multiple local
drives.

- **Organization:** Companies can also achieve efficiency by using the cloud to have
a single set of standardized folders used throughout the enterprise. Doing so is
not only helpful at the user-level (in that each person doesn’t create her or his
own set of folders), but it also creates a common library of documents that can
be accessed to find information across the company on a particular matter or
franchise. Use of a standard folder system may also assist in a transition, if an
employee is absent or leaves, and his or her replacement needs access to those
files.

- **Access Anywhere Anytime:** With an Internet connection, franchisees and
employees can access the cloud database from any location and on any
platform, whether a laptop, Blackberry, iPhone, iPad, or any other device with
Internet access. (Of course, as noted above, the ease of access is a double-
edged sword, and can leave security vulnerabilities).

- **Easy Share of Real Time Access To Others:** Login permissions can be provided
to outside accountants, attorneys, and franchisees, which can help reduce the
franchisor’s administrative time of compiling and ‘pushing’ such information to the
recipient.

- **Disaster Recovery:** Downtime in the event of a work interruption event (e.g.,
power surge, fire, flood, other natural disaster) occurring at the franchisor’s
premises will be reduced. Files and reporting remain intact in the cloud. While
service providers are also susceptible to natural and other disasters, most cloud
providers have thorough backup systems and preserve data in multiple locations.
This storage model significantly reduces the likelihood of lost data and allows for
fast recovery. Any company considering working with a cloud computing
provider should conduct due diligence to determine whether the service provider
utilizes a multiple location repetitive storage method.

### 3. Disadvantages of Cloud Computing

- **Cost of Migration:** Franchisors may avoid up-front acquisition costs of software
by paying ongoing monthly fees, but not everything is cheaper in cloud
computing. Companies can incur significant cost migrating an existing system
into the cloud. To create an effective cloud computing system, the franchisor
may need to spend considerable time (and consultant fees) finding, converting
and migrating all of its existing data to the new system. Incompatible file types
and other migration issues may arise and, if so, there will be costs associated
with resolving those issues. These costs may be prohibitive for some
franchisors.
• **Total Cost**: Depending on the franchisor’s needs and use of the software, it might be more expensive to pay monthly rental fees as opposed to hosting computer services themselves. This is especially true in small systems with limited headquarters’ staff. Some of these costs may be passed on to the franchisees, depending on the terms of the franchise agreement, and franchisor should amend agreements that don’t allow for technological cost sharing. If costs are passed on, the franchisor should educate its system so the franchise understands that it is receiving value for those technology costs.

• **Entrenchment**: Some cloud applications are built on a proprietary platform, which limits the franchisor’s ability to move to another provider if they are dissatisfied with the service. Further, the franchisor may have to incur another set of migration fees in order to move to a different provider. Similarly, the franchisor must be aware that an unscrupulous service provider may recognize these issues and use the franchisor’s lack of mobility as a bargaining tool in any negotiation once the franchisor is on board.

• **Privacy**: Franchisors may be under a legal obligation to protect personally identifiable information (“PII”) that they collect from customers, employees, franchisees, and other parties. To the extent that PII is stored in a cloud database, the franchisor needs to consider where, and how secure, the service provider’s servers may be. Some data cannot be shared across borders without taking special precautions (e.g., PII collected from residents of the EU, pursuant to the US-EU Safe Harbor Framework), and other data may be sufficiently sensitive that it should not be stored outside the country, lest a data breach lead to especially difficult brand damage for the franchisor. A franchisor must implement safeguards against unauthorized access of PII by the provider, a method of recording and logging any access by the provider, and a framework for monitoring how personal information is being used by anyone with access to the information.

• **Security**: There are similar concerns regarding hacking and unauthorized access to secure information stored in the cloud. Different service providers can support different levels of security for customer and corporate data. Franchisors must ensure that the hosting company is able to meet their security requirements.

• **Control**: The franchisor loses some control over IT service levels, as the franchisor must rely on the hosting company’s tools and staff to provide critical

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4 As just one example of a policy dealing with the storage and the possible loss of security of PII, see U.S. Department of Health and Human Services, “Policy for Responding to Breaches of Personally Identifiable Information (PII),” available at www.hhs.gov/ocio/policy/20080001.003.html (Nov. 17, 2008).

computer applications. If anything goes wrong or there is a service interruption, the franchisor is dependent on the service provider’s customer service. If the service provider’s server fails, this could result in a company-wide work stoppage for the franchisor. Backup and recovery processes are controlled by the service provider, so franchisors must ensure that the backup provisions are sufficient to meet their needs.

- **Customization** - Not all service providers are willing to customize their software for the needs of the franchise industry.

- **Availability**: In addition, if the internet connection is down or the cloud portal is unavailable for some reason, there is virtually no ability to continue to work locally, as there is no data or software housed on the user’s terminal.

- **Resistance by Franchisees**: Franchisees may resist the migration to cloud computing for many reasons (see the discussion below in Part III of the paper), including paying the service provider’s fees, especially if the franchisees have recently upgraded their local hardware or software.

C. THE SERVICE AGREEMENT

1. **Common Contractual Terms**

Cloud computing requires franchisors to cede control of their most important asset, information, to a third party. As such, it is important to ensure that any agreement with a cloud computing service provider allows the franchisor to retain as much control over and oversight over the information as possible, including ensuring that the service provider has adequate safeguards in place to protect that information. Some of the most important topics to be covered in a service agreement with the provider are discussed below. Many of the points noted below, while covering different points in an agreement with a cloud computing service, are quite similar in nature to those likely to be found in an agreement with any other outsourced computing company.

(a) **Information Ownership**

Most agreements will specifically address the ownership of a company’s work product. All information stored with the provider must remain the property of the franchisor, despite being housed at the provider’s location, and must be designated as confidential to the franchisor. Information relating to the provider’s system design will typically remain the property of the provider. In the case where the provider customizes the cloud solution, the franchisor and provider will need to negotiate who owns the copyright related to the customization.

(b) **Reliability**

While cloud computing provides a reasonably safe solution to companies, it is still important to confirm the cloud solution can continue to perform if “the worst disaster"
should occur. Providers should be willing to warrant that their system will be able to handle such an event. Testing, however, is paramount to ensuring the service provider will be able to perform as well (or better) than the franchisor should a disaster occur. The franchisor should require the service provider to “stress test” their systems and be able to recover quickly from a disaster. Test results should be provided at least twice a year.

Even outside the context of a disaster, it is important to ensure that the service will be consistently available to the franchisor. The agreement must include quantifiable service standards to address this issue, with financial implications to the provider if they are not able to achieve the service standards.

(c) Maintenance and Support

One benefit of a cloud solution is that it reduces the need for internal information-technology employees. However, in order to ensure that this efficiency is realized, it is important to ensure that the provider will provide adequate information technology support to the franchisor. The agreement must state, with as much objective detail as possible, what constitutes adequate support, including application up-time, downtime expected for maintenance, scheduling of maintenance, hours of operation and help-desk availability, response times for critical and non-critical issues, chain-of-command reporting, and escalation procedures.

(d) Security

Franchisors need to request a security plan from the service provider, which will typically include technical specifications, a physical security checklist and third party hosting specifications. In addition, the franchisor should get a representation and warranty that the cloud service provider’s website and the cloud computing server sites are, and will continue to be, secure. The secure sockets layer (SSL) or transport layer security (TSL), which are represented by https:// rather than http://, are cryptographic protocols that are commonly employed for security purposes and are used in relation to the connection between the user and a specific web application.

Providers may employ multiple levels of security for cloud computing. Franchisors should investigate the accreditation of the cloud service provider and the franchisor's internal physical security and risk management policies. A cloud service provider should be able to provide evidence as to their server hosting environment.6

(e) Privacy

When determining how deep to dig into data center specifications and hosting specifications the requirements should be fair and gauged on the risk to the franchisor if the hosting facility’s security is breached. If customers’ PII or if franchisees’ PII is lost,  

stolen, or otherwise compromised, that may have a significantly larger financial impact than stolen strategic or financial information – and may also lead to brand damage.

In addition, failure to protect data may lead to enforcement action by the FTC, especially if the company has made commitments that it will do so. For example, in the case of well-publicized data breaches that took place at various outlets of The TJX Companies, where over 45 million credit and debit card numbers were stolen from the company’s systems, the Commission acted when it determined that the company “failed to provide reasonable and appropriate security for personal information on its networks.”

Before contracting with a cloud service provider, a franchisor should obtain a copy of the provider’s Employee Confidentiality Policy and may also consider asking the provider to name the franchisor as a beneficiary in the service provider’s business liability and errors and omissions insurance policies (although it is unlikely that a large service provider would agree to this). The franchisor could also attempt to secure its own insurance in the event of the loss of personal information. Franchisors in the United States that collect data from individuals in the EU should insure any provider with which they contract complies the FTC’s “Safe Harbor” standards for privacy.

In April 2011, the FTC completed its first case alleging breach of the US-EU Safe Harbor Framework. In announcing its proposed consent decree with Google, Inc., the FTC explained that it had alleged that Google misrepresented its data policies as well as the company’s compliance with the Safe Harbor program. The FTC published a proposed consent decree relating to Google’s now-abandoned “Buzz” cloud program. In the Commission’s news release, the agency summarized its action as barring “the company from future privacy misrepresentations, requiring it to implement a comprehensive privacy program, and call[ing] for regular, independent privacy audits for the next 20 years.”

In Canada, if information is being transmitted to a third party for storage, then the agreement between the company and the service provider must explicitly specify that the service provider may not use any personal information other than in relation to

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7 See, e.g., In the Matter of Twitter, Inc., FTC File No. 092-3093 (Mar. 2, 2011); In the Matter of Rite-Aid Corp., FTC File No. 072-3121 (July 27, 2010); In the Matter of The TJX Cos., Inc., FTC File No. 072 3055 (Aug. 1, 2008).


9 See note 5, supra.


performing the service. Other privacy provisions a franchisor may wish to consider including in the agreement could include any of the following:

- Provider will not collect any personal information from or disclose any personal information to any person, organization or entity other than the franchisor;
- Provider will segregate the personal information from any other information, files, or records it maintains and will secure the personal information against loss or theft, as well as unauthorized or unintended access, disclosure, copying, use or modification;
- Provider will refer to the franchisor any individuals requesting access to their personal information; and
- In relation to the provision of insurance, as noted above, the provider will indemnify and hold harmless the franchisor from any costs, expenses, award of damages or settlement made in relation to any improper disclosure of personal information.

(f) Location of Information

The franchisor should pay attention to the governing law clause in its agreement with the service provider, as some providers may physically house the franchisor's information in servers located in a foreign jurisdiction. If the franchisor is concerned about the ability to enforce a judgment against a provider where the assets is located extra-territorially, the franchisor may consider requiring that all information be stored in a particular country or countries. In some countries the franchisor may also have to consider privacy legislation as it relates to the extra-territorial transfer/storage of information.

(g) Audit Right

In its contract with the service provider, the franchisor should reserve the right to review and audit the provider's books and records. This review should include records relating to the performance of the services, and books and records containing or relating to maintenance of PII. The franchisor also must have sufficient rights so that it is able to verify the provider's compliance with the terms and conditions of the contract.

(h) Expiration or Termination

The cloud service agreement should specifically contemplate the sequence of events that will take place upon termination or expiration of the agreement. Among other things, this must include return of information (or a period of time during which the franchisor can access and download that data) and a transition period during which the franchisor can migrate to a new service provider. In addition, the agreement may set out that the provider must cooperate and work with the franchisor's internal information
technology employees or the new service provider in order to transition to the new system the franchisor has elected to use. The agreement should also set out whether the franchisor is responsible for any/all of the costs associated with such a transition.

It is very important that a franchisor contemplating a move to the cloud carefully review its contract with the provider and not simply assume that the provider agreement is non-negotiable.

D. FACTORS TO CONSIDER IN SELECTING A CLOUD PROVIDER.

Among other things, a franchisor considering which cloud provider to choose should weigh various factors, including the following:

- Consider in advance the exact solution required; determine and outline the franchisor’s needs and requirements. This should be done before evaluating services offered by different cloud providers.

- Determine where the cloud provider and its servers are located, especially if storing sensitive customer personal data in the cloud.

- Check whether the cloud provider has a security certification and that the level of security they offer meets the franchisor’s needs.

- Consider whether the cloud provider is willing to provide service and reliability guarantees. For example, “uptime guarantees” assure users that the cloud service will remain running for a certain minimum percentage of the length of the contract.

- Examine whether the cloud provider is able to customize and adapt their generic software to meet the franchisor's needs and what the costs of such upgrades would be.

- Find out whether the cloud provider services other clients in the industry and then check with some of those clients to confirm their satisfaction with the software application and support service provided.

- Investigate whether the cloud provider has sufficient capacity to support the franchise at the required service level. Consider what would happen if the franchisor grows beyond the capacity of the original agreement.

- Determine whether the cloud provider’s application program interface (API) is widely used in order to maximize future options of complimentary services from other providers as well as to allow for migration to other providers.

- Conduct due diligence relating to the cloud provider’s server back-ups, redundancy and disaster recovery plans.
Require that the cloud provider have errors and omissions and liability insurance.

III. ELECTRONIC LISTINGS, DIRECTORIES AND SOCIAL MEDIA RESOURCES: KEEPING UP WITH ONGOING CHANGES

A. THE TIMES THEY ARE A-CHANGING

In October 2008, a Web Server Survey conducted by NetCraft found that the Internet had 182 million websites.\(^{12}\) In January 2011, the same Web Server Survey found 273 million sites.\(^ {13}\) Internet usage has also grown: from 16 million users in 1995, representing .4% of the world’s population, to nearly two billion users in 2010, representing 28.8% of the world’s population.\(^ {14}\) In North America, the population penetration of the Internet is at 77.4%.\(^ {15}\) Nothing in the literature proposes that the growth of the internet is slowing. It is vitally important, therefore, that franchisees take advantage of the advertising and marketing potential for reaching vast numbers of potential customers. But it also creates significant challenges for franchisors attempting to protect their trade names and systems and to control their branding online.

B. “PIP” – THE PRE-INTERNET PERIOD

While controlling franchisee advertising in the Pre-Internet Period has always required diligence on the part of franchisors, it was much easier to prevent or stop unapproved advertising by franchisees, whether print or on-air advertising. In the Pre-Internet Period, virtually all advertising had a finite time in market. On-air ads would run for a set period of time and stop running once payment stopped. Ads in newspapers, directories and magazines would be in the public realm only as long as the lifecycle of the publication. During the PIP, it was a relatively easy task for franchisors to identify the publishers and notify them of any improper use of its trademarks. While these procedures might take time and money, it was relatively easy for franchisors to protect themselves against unfettered misuse of their trademarks and tradenames in advertising. Additionally, in the PIP and still today, in conventional media, “advertising editors” exercise an additional degree of scrutiny that makes it less likely for a rogue party to run advertising that is improper or in derogation of another party’s rights.


\(^{15}\) Id.
In years past, franchisors also had the power to control the central point of contact for consumers – the telephone number. In the not-so-distant past, if a consumer wanted to find a product they would flip through the Yellow Pages until they found the product and a list of providers. Franchisors could control this listing fairly easily by using the Franchise Agreement to require any telephone number related to the franchised business be transferred to them in the event that the franchise agreement was terminated. In some cases, a franchisor would create the listing on behalf of the franchisee, and would “own” the ad. If the franchisor permitted its franchisees to create the listing, the franchisor could hold an executed Telephone Transfer Assignment Agreement in escrow until termination, or the franchise agreement itself could state that the telephone number would be transferred in the event of termination. Franchisors could contact the telephone company, present either contract, and take control of the telephone number. A yellow pages advertisement would continue to direct customers to a number that could be monitored by franchisors or transferred to another local franchisee, meaning that continuity could be maintained and consumers may not even realize that any change took place in the ownership of an outlet. If a franchisor did not wish to monitor the number, or if there was no franchisee in the area, they could disconnect the number and, at the very least, limit the former franchisee’s ability to compete.

For those franchisors that did not wish to take over the telephone number and incur the cost to do so, all that they really had to do was wait. The franchisor could notify the telephone company of the trademark usage and request that the account not be allowed to renew and/or the franchisee would be unlikely to pay to renew a yellow pages advertisement for a business that it no longer operated. Either way, the next edition of the directory would not include the franchisee’s listing. This was a practical and convenient way of limiting the continuation of advertisement for a defunct franchise location.

Then came the Internet.

Today, if you start a search for a product name in your computer or smart phone, a plethora of directories, listing, e-newsletters, blogs, and social media pages describing hundreds of providers appears, including your franchisees. Each of these listings creates a new challenge to franchisors. Franchisors must now monitor the internet, searching for listings identifying their current and former franchisees to ensure that their trademarks are being properly used, that advertisements are accurate, that blogs don’t cross the line from informative to disparaging, that consumers can find their franchisees, and that listing are not feeding business to former franchisees. While franchisors can require that franchisees obtain prior approval before they post to directories, it is still important for the franchisor to monitor the internet regularly. This allows franchisors to promptly act where an existing franchisee has failed to obtain approval, as well as when a franchisee who has exited the system still has information on the Internet. It’s not simply getting a telephone number transferred, waiting out the update to the directory or contacting a publisher. Now franchisors must be proactive in searching for listings and getting them removed or changed to remove the former franchisees information.
C. THE LOOOOOOOOOONNNNNNNNNGGGGGGG MEMORY

The internet has a long memory. As one internet blogger put it, “[a]ssume that everything you put on the internet will remain there forever.”\(^{16}\) This is because, as anyone who has ever tried to expunge information from the internet has found, what is put on one site doesn’t stay there. It travels from one place to another. One site will take information from another site and post it, then another, then another, and soon the information is, seemingly, everywhere.

In preparation for this paper, we searched the internet using just the telephone number of local businesses. One number was for a local garage. This garage has been in operation for 25 years, but new owners purchased it five years ago. The new owners changed the name, keeping the same phone number. When the business phone number was entered, 67 directory listings were found. Of those listings, 48 were for the new name and 19 were for the old name. A search of the business name came up with 63 different listings, and a search of the old business’ name came up with 28 different listings, five years after the change. The directories included Bing, Getfave, Merchantcircle, Localyahoo, Superpages, Whitepages, Mojo, Insiderpages, Dexknows, Yellowpages, Repairal, Yellowbook, Manta, Switchboard, Hotfrog, and more.

When the owner of the garage was asked if he had advertised on all these sites, he was shocked to learn that there was so much information about his business on the internet. He had only signed up for a yellow pages listing and was unaware that other directories had also picked up his business information. When asked about the listings under the old business name, he couldn’t have been happier, because consumers looking for the old business would be directed to the new business number, thus he could continue to get customers who had been familiar with the old business.

The former business owner had moved, however, and opened another garage. When asked how he felt about his name continuing to be linked with a competing business, he was not quite as happy. He wanted his old customers to be able to find him and was disappointed to learn that he was, in essence, competing with himself for their attention. Among other things, the former business owner was interested in learning how to correct the problem, but he faced a thorny problem that many business owners now commonly encounter: how to get rid of old, inaccurate, and damaging search results.

These concerns are the same as those faced by franchisors in the world of on-line advertising and the long memory of the internet. How do franchisors advantage the brand and the franchisees through Internet advertising, while controlling the message and protecting the system?

\(^{16}\) Leo Notenboom, blogger at AskLeo.com.
D. PROTECTING THE BRAND

Enter a brand name in any search engine: if the brand owner has been in business for more than a year, you will likely find thousands of sites with information about the brand; phone numbers of franchisees, blogs, Facebook and LinkedIn references, social media pages about the franchisees, as well as links to articles about the brand and websites for some franchisees. The amount of information is overwhelming. While this level of detail can be a great benefit for franchisors, it may also raise concerns. For example, how does a franchisor keep control of its message? How do franchisors monitor what has been written about their brands, and how their franchisees use the marks? And how do franchisors do all of these things efficiently?

So what is a franchisor to do? Franchisors must accept that Internet advertising is not going to go away. By all accounts, it is going to continue to expand with more and more users. Fortunately, franchisors can take steps to try to protect themselves from improper use of the Internet now, so as to avoid problems later. Even though franchisors cannot expunge every piece of advertising placed on the internet by their franchisees and others, there are steps that a franchisor can take to control much of that content. This requires proactive analysis at the time of drafting the Franchise Agreement and diligence in monitoring the brand on the Internet.

E. THE EXISTING TOOLBOX

The most powerful tool in a franchisor’s toolbox is still the franchise agreement. A well-drafted, well-thought-out agreement can protect a franchisor from changes that arise in the world of technological advancement. Most franchisors should also take comfort in knowing that their franchise agreements predating the internet will still likely provide the ability to control a franchisee’s use of trademarks on the internet, and still provide the franchisor with the right to review and approve (or disapprove) proposed advertising, even on the internet. Some examples of language that pre-dates the growth of the internet might include language similar to the following:

1. Restrictions on Advertising:

“Franchisee agrees to submit to Franchisor for Franchisor’s prior written approval all advertising and promotional materials to be used by Franchisee, including without limitation, all telephone directory listings, brochures and classified advertisements and listings. Franchisee agrees not to use any advertising or promotional materials not previously approved by Franchisor or which do not include all copyright or trademark notices in the manner prescribed in writing by Franchisor.”

2. Ownership in the Marks

“Franchisee acknowledges the Franchisor is the sole owner of the tradenames and trademarks licensed to Franchisee by this Agreement. Franchisee agrees to use such tradenames and trademarks in full compliance with rules prescribed from time to time by Franchisor and all such usage will inure to the exclusive benefit of Franchisor.
While none of these provisions specifically address the technology of the Internet, each provides the franchisor with the ability to regulate advertising of their franchisees and their use of the franchisors’ trademark, as well as providing franchisors with the ability to take over ownership of telephone numbers used in the franchised business in order to direct telephone traffic to the former franchisee’s number. Used together they create a blanket of protection. In practice, they may be used to default franchisees who fail to properly advertise, they protect trademarks from franchisees’ improper use, and they create the ability to keep connected with consumers after the termination of a franchise agreement.

F. THE NEW TOOLS

As helpful as it is to have foundational provisions that allow franchisors to protect their system, franchisors can increase their ability to protect their brand image on the Internet. There are three major connections to the Internet that must be addressed. First is the right of franchisees to create an online presence for their franchised business through websites and blogs. Second is the right of franchisees to participate in social media on behalf of their franchised business (as opposed to solely for personal matters), and third is the ability of franchisees to maintain internet directory listings. Each can be controlled by the Franchise Agreement, and franchisors should ensure that they are covered.

1. WEBSITES

The popularity and efficacy of Internet advertising creates a need to address how and if franchisees will be allowed to operate websites for their franchised businesses. As one franchise executive put it to this author:

I’m probably biased, but for franchisors to not encourage their franchisees to have SOME web-presence seems VERY short-sighted. While the management of franchisee website is not a trivial task, it is a crucial marketing tool for any business these days and franchisors not providing a system
for website creation and management is likely at a disadvantage.17

The decision to provide a system for website creation and management is a business decision each franchisor must make, but regardless of whether it wishes to allow website participation by its franchisees or not, it needs to make sure that it contemplates the matter in the Franchise Agreement.

Franchisors need to include specific prohibits in their franchise agreements against the unfettered creation of websites by franchisees. An example of language is:

“You specifically acknowledge and agree to not establish a Website or Blog, nor offer, promote, or sell any Products or Services, or make any use of the Marks, through the Internet other than in a manner approved by us. As a condition to granting any such consent, we have the right to establish such requirements as we deem appropriate, including but not limited to the requirement that your only presence on the Internet be through a webpage we have established on our website.”

Such language grants the franchisor the ability to direct website activity, even where it has not yet created its own franchisee website system. The manner of website activity is directed by the franchisor, and the broad language allows for evolving needs of the system.

One option for franchisors is to provide their franchisees with a personalized Uniform Resource Locator (pURL) linked to the franchisor’s home website. The franchisee is provided with a personal web address, for example www.franchisor.com/franchisee. This allows the franchisor to control the design and format of the site, maintaining continuity and consistency across the brand. It also allows the franchisor to update content to ensure the most recent information about the franchisor’s brand is available to consumers. In addition, the franchisor may monitor activity to the franchisee’s pURL, creating a resource for statistical market analysis. Franchisees benefit from having their own website address that they can use in their marketing efforts. Also, upon termination of the franchise agreement, it is a simple matter for the franchisor to deactivate the franchisee’s pURL.

There are numerous products (and off-the-shelf solutions) for franchisors to create pURLs and micro-sites for their franchisees. One example of software is WebTreePro, a Primero Systems product that allows franchisors to create templates that maintain brand integrity while granting the franchisor maximum control over the franchisee’s local website. These solutions do not come without a cost, however, which must be factored into the franchisor’s decision making. A number of providers offer franchisors the ability to create and update the pURL system. The cost can vary between upfront franchisor costs of $10,000 to $15,000 plus annual per franchisee costs ranging from $200 – $400.

17 Patrick J. Conley, Vice President of Business Systems, Franchise Source Brands, International.
a year to maintain the systems. Much of this cost can be offset by the franchisor through the implementation of technology fees. More and more, franchisors are charging monthly technology fees in order to cover the on-going support expenses of these kinds of services for their franchisees.

Some challenges exist for franchisors that do not provide franchisees with a pURL. Where franchisees are allowed to create their own websites, some franchisee will not create their own websites while others will spend thousands of dollars to out-do other franchisees. Challenges arise for franchisors when the franchisee markets outside their own territories or when the franchisor must get former franchisees to cease using their brand names and trademarks. If franchisees have independently set up websites, deactivating them will take some cooperation from the franchisee, which may not be in abundant supply following termination. Further, without oversight by franchisors, consumers doing searches on search engines are likely to be overwhelmed by the results and confused about which link they should follow.

We would recommend against franchisors permitting their franchisees to have independent websites. The only logical place for a franchise system to have a web presence is on the franchisor’s central site, with appropriate web pages on that site for each franchisee. (For one example, see the Spring-Green website: www.spring-green.com. By entering a zip code, the customer can be directed to the local franchisee’s webpage.) Having a tool to permit franchisees to create their own independent sites (as opposed to microsites within the franchisor’s site) creates significant problems for franchisors, including not only look and feel, content, and the like, but also domain names. Franchisors should consider as well the costs in time and money to get sites shut down where a franchisee refused to cooperate. While we believe that the need for franchisee websites is great, a franchisor would be better off simply forbidding the creation of any website than to allow independent websites to be created by their franchisees.

Another important issue franchisors need to consider is email addresses for the franchisees. Franchisors should provide branded domain email addresses for their franchisees. It is not only a marketing tool for the franchisees, but another point of control over the branding message; allowing the franchisor to control the use of the trademarks. Where franchisors provide branded domain email addresses, they should require that franchisees only use the provided email address in their communications related to their business. In addition to system-wide continuity, it grants the franchisor another point of control over the ability of former franchisees to compete. Granting a branded domain email address to franchisees allows the franchisor to terminate email service following termination or expiration of the franchise agreement, as well as allowing franchisors the ability to redirect emails sent to former franchisees to other franchisees within a market.

One specific prohibition that should be included in the franchise agreement is against using the tradename or trademarks in a domain name or email address. While it might be desirable to have consumers be able to locate franchisees by entering the franchisor’s brand into their computers, the franchisor does not want to have multiple
domains or email addresses with the franchisor’s tradename or trademarks owned by third parties. The primary concern to franchisors should be the use of tradenames in any domain or email address. Such usage creates the very real potential of improper competition by former franchisees as well as the dilution of the trademark and likelihood of confusion. In order to protect the franchisor’s trademarks, franchise agreements should specifically prohibit the use of the tradename and franchisors should police domain names and their franchisees’ email addresses diligently.

There are many free resources on the Internet for monitoring domain names, such as WHOIS.com, networksolutions.com, and Godaddy.com. Any WHOIS search will identify the registrant and the website host. If a franchisor learns that someone has registered a domain name using its tradename, it should immediately contact the registrant and require them to transfer the domain name to the franchisor. This is typically accomplished through a notice to cease and desist. If it is a franchisee, failure to do so immediately should be a default of the franchise agreement.

In some cases, the registrant has registered the domain name “by proxy.” This can make it difficult to find the owner of the domain. If a search of the website itself does not identify the owner, or if the owner of the domain name refuses to transfer the domain name, you should immediately contact the domain host and follow their procedures for reporting trademark infringement. A number of hosts post online forms which can be completed and sent, along with a copy of your trademark registration, to their compliance department. If the host finds that you have a legitimate claim to the tradename, they may shut down the site until the matter is resolved.

In the meantime, the franchisor can pursue legal action to force the transfer of the domain name if the registrant refuses to comply with its request. This can be accomplished through an injunction before courts in the U.S. under the Anticybersquatting Consumer Protection Act18 or through a proceeding under the Uniform Domain-Name Dispute-Resolution Policy (“UDRP”)19 established by the Internet Corporation for Assigned Numbers and Names (“ICANN”). Under the UDRP, a claim can be brought through ICANN’s approved dispute resolution service providers (e.g., WIPO). An ICANN arbitration proceeding is undertaken entirely on paper, without the need for costly hearings.20 Either the complainant or the respondent may choose a three-arbitrator panel instead of the standard one-arbitrator panel, and if the panel determines that the disputed domain name was improperly registered or registered and

19 See http://www.icann.org/en/udrp/.
20 Arbitration under the UDRP is not a formal “arbitration” for the purpose of the Federal Arbitration Act, and therefore, parties may seek relief in court if they disagree with the panel’s decision. “[U]nlike methods of dispute resolution covered by the FAA, UDRP proceedings were never intended to replace formal litigation.” Dluhos v. Strasberg, 321 F.3d 365, 371 (3d Cir. 2003). See also UDRP ¶ 4(k), which specifically allows the parties’ right to seek relief in court if they disagree with the panelist’s decision.
used in bad faith, then the panel may order that the domain name registration be transferred to the rightful party.

Regardless of whether franchisors provide a pURL to its franchisees or allows them to register their own domain names for the franchised business, it is important for franchisors to create guidelines for the content included on any website. We would recommend that franchisors design and provide their franchisees with templates for their websites in order to ensure continuity and consistency. Franchisors should also ensure that they have the authority to provide content which franchisees are required to post on their websites. Much as with traditional print advertising, franchisors may not choose to provide content, but it should have the ability to do so.

2. SOCIAL MEDIA AND SOCIAL NETWORKS

Social media and social networking sites cannot be overlooked. Facebook had approximately 400 million users in February 2010 and it is projected that this will increase to 630 million in 2011.21 While an exhaustive discussion of social media issues is outside the scope of this paper, it is important to address the very real need to protect the franchisor’s system by creating guidelines for the use of social media as it relates to the franchised business. In order to accomplish this, it is important that franchisors create a social media policy for inclusion in their operations manual, and require the franchisees to abide by the policy. Among the other language that franchisors can include in their social networking policies might be the following:

“You may participate in Social Media and Social Networking in accordance with our Social Media Policy, which we may amend from time to time. You must provide us with all Social Media account information we request and as a condition to allowing you to use social media and social network sites, you must grant us independent access to your Social Media accounts in order to make upgrades, post and delete information, and manage the Social Media account as we deem appropriate for the benefit of your Social Media efforts and the System.”

Any social media policy should address some very fundamental rules for the franchisee’s use of social media. Among these are:

_Honesty is the best policy_

The policy should require that all social media postings be truthful and honest. Dishonesty creates an image of untrustworthiness that can permeate across the entire system and bring disrepute to your brand. In addition, including this requirement in the policy will help attenuate franchisors from claims of false advertising brought against the franchisee (and potentially the “deep pockets” of the franchisor) should they make any misrepresentations.

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If you don’t have something nice to say, don’t say anything

It is important that the policy contain strong anti-disparagement and anti-vulgarity language. Franchisees should never use a social media forum for airing their complaints against the franchisor, other franchisees, competing business, other individuals, or in any other manner. Nor should franchisees ever be allowed to use vulgar language on their franchised business sites; doing so would send a strong negative image of the system’s brand out into the world. Franchisees should be instructed to always represent the franchised business in a professional manner for the benefit of other franchisees and their employees, as well as the franchisor.

If it’s not yours, don’t use it.

Ensure that your policy has a strong prohibition on the use of other’s copyrights and trademarks. Instruct your franchisees that they must always give credit for other people’s work and make sure they have the right to use something before they post it. Another option available to the franchisor is a blanket prohibition against the use of any third party material at all rather than leaving it to the franchisees to judge whether they have the right to use this material. This is something the franchisor needs to consider. The improper use of others’ copyrighted materials or trademarks can lead to costly litigation against the franchisee and franchisor. Having a policy in place will help to protect franchisors from third-party claims arising out of misuse by franchisees. Franchisors should also include any specific guidelines about the use of their own trademarks. Franchisees should update as the trademarks change or use them in accordance with the franchisors’ policies on the use of trademarks in advertising.

It’s a secret

Require that all franchisees protect confidential and proprietary information and trade secrets at all times. It might seem rather apparent that franchisees, who are typically subject to confidentiality clauses in their franchise agreements, would know this, but on social media sites, people can forget that they aren’t just chatting with friends; they are sharing with the world. Keeping the need for confidentiality at the forefront of their social media experience is very important.

Your personal business is YOUR personal business

Again, a social media website for a franchised business is not the same as a personal social media page. Therefore, it is important that the policy remind franchisees that personal information that has no bearing on the franchised business should not be allowed on social media site related to the franchised business. Photos from a franchisee’s vacation may be perfectly acceptable when promoting a travel agency business, but have no place on a website about cleaning services.
Where have you been?

The policy should also include requirements for keeping any social media sites active, and franchisees must appreciate the ongoing commitment required for any social media activity. Franchisors do not want consumers going to sites where postings are months or years old. This sends a message to the consumer that the business is not active. If your franchisees are going to participate in social media, you should require that they update their sites frequently.

What’s yours is mine.

The policy should require that the franchisee provide the franchisor with the names of all social media sites where it participates, and the franchisee should be required to provide the franchisor with access to those sites. This will allow the franchisor, if needed, to remove inappropriate materials posted on the site, and allow the franchisor, should it choose to do so, to propagate material about the brand on the website. There are a number of software programs that allow franchisors to post articles, materials, advertisements, and other information about the brand into the social media sites of their franchisees en masse. Franchisors should protect their ability to do this should they choose to do so.

In addition to the Social Media policy, franchisors should include in the franchise agreement a requirement that the franchisee abide by the policy, as well as identifying whether or not social media will be treated as advertising outside of a franchisee’s territory or market. Since social media does not have geographical boundaries, franchisors should determine how social media impacts its advertising rules. One way franchisors can avoid the problem is by creating a carve out in their franchise agreement that states that franchisee participation on social media websites is not considered marketing outside any territory or infringement into other franchisee’s territories, provided that the medium, content or target of the advertising is consistent with the franchisor’s policy. Further, franchisors must appreciate that they may be called upon to adjudicate disputes between franchisees if one believes that there has been a violation of the policy.

Franchisors should review their older franchise agreements to determine if any territorial restrictions contained therein would prohibit newer franchisees from participating in social media for their franchised business. If so, franchisors may need to address these issues through a buy-in or other negotiations with existing franchisees.

3. INTERNET DIRECTORY LISTINGS

As discussed above, once information is entered into an online directory or listing, one site feeds off another site and so on, spreading the information across multiple sites. While it is possible to try and contact each directory and notify them that the franchise is no longer in operation, less reputable services may not have the manpower or desire to resolve conflicts. In addition, attempting to attack all postings is a time consuming and burdensome task.
This is where the assignment of a telephone number is important. If the franchise agreement does not currently have a telephone number assignment requirement, the franchisor should include it in the agreement, and specifically reference electronic listings and directories. Having ownership of the number will allow franchisors to direct consumer calls and avoid the ability of former franchisees to compete by servicing old clients as well as avoid them using the brand to create new clients.

If a franchisor does find itself in a situation where it must contact a directory, having ownership of the number will simplify the process. Rather than the need to prove a prima facie case of trademark infringement, the franchisor can present the confirmation of ownership of the telephone number. This also assists the directories in ensuring that they are a reliable source of information to their own customers.

G. CONCLUSION

In a world of rapidly changing and expanding technologies, it is impossible for any franchisor to create a protocol that will protect it from every possible circumstance. Maintaining an eye on the trends of technology while ensuring that fundamental protections, such as a telephone number assignments, trademark and confidentiality provisions, advertising guidelines, and updated operations manuals is the best way to ensure the wellbeing of a franchise system. Another important component for any franchisor is a willingness to adapt to changing circumstances that affect systems and franchisees. Franchise agreements should always leave the franchisor with enough room to navigate the changing seas of technology.

IV. ROLLING OUT NEW TECHNOLOGY MID-TERM

This portion of the paper focuses on the legal and business issues raised when franchisors introduce change – specifically technological change – into franchise systems, such as introducing new practices, computer systems, hardware and software. Further, franchisors do not have the luxury of waiting for an opportune time to introduce system-wide changes, and typically these changes occur during the term of the franchisees’ franchise agreements.

Technological change is not always glamorous. Unlike other system changes, which may focus on increased profits for both the franchisees and the franchisor (e.g., the addition of a new product offering), some technological change may be required to introduce or support back-office systems or other non-revenue generating programs. Also, not all change involves the addition of new technology. A franchisor may elect to retire obsolete equipment or cease offering a particular service (e.g., back-office accounting system) because the system is outdated and too expense and cumbersome for the franchisor to support and maintain. Regardless of the nature of the technological change, franchisors must consider the following key issues in order to help successfully plan and implement the change on a system-wide basis.
A. LEGAL ISSUES

When a franchisor identifies an opportunity to introduce a technological change to the franchise system, it must first consider the legal issues raised by implementing the change.

1. Does the franchisor have the right to require the franchisees to purchase the technology?

The proposed change may require franchisees to purchase new equipment to support the new technology (e.g., purchasing point-of-sale cash systems). While it may be trite to say, the franchisor must determine whether it has the right to require franchisees to purchase the new equipment early in the planning stages of implementing the new technology. This question must, of course, be answered on a case-by-case basis. In considering this issue, the franchisor must consider:

- Are the agreements silent on the purchase of new equipment?
- Do the agreements expressly address the purchase of new technology-related equipment, or must the franchisor rely on a general provision?
- How well is the provision drafted? Does it clearly contemplate the type of change that the franchisor intends to introduce?
- Are there any maximum caps in the agreements that may be exceeded with the purchase of the new equipment?

To reach an answer on this issue, the franchisor must conduct a due-diligence review of the franchisees’ franchise agreements. As with any due-diligence undertaking, the extent and density of the exercise will depend on the complexity, number and clarity of the agreements, the number of franchisees, and the number of versions of each agreement.

In addition to a contractual review, franchisors must also consider any restrictions imposed by law. This would include contemplation of the franchisor’s duty of good faith. While a discussion of the duty of good faith and fair dealing is outside the scope of this paper, it is worthwhile to note that some system-wide changes have in the past been the subject of class proceedings challenging the franchisor’s ability to implement a change (even in the face of an express right in the franchise agreement), including on the basis of a breach of the franchisor’s duty of good faith. While these cases were not expressly relating to technology change, they still present warning to franchisors implementing any change.

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If the agreements collectively do not permit the in-term implementation of new technology, the next best possibility is for the franchisor to consider whether any necessary changes can be made to the franchise renewal agreement in order to require franchisees to adopt the technology at their next renewal. Clearly, this is a distant second-best option given that the roll-out will, by necessity, be phased in over a longer period (how long will depend on the length of the term in the franchise agreement). However, the relationship laws of certain jurisdictions may restrict material changes in renewal agreements, which puts the franchisor in no better position than it was during the term.

The results of the franchisor’s investigation may result in the franchisor concluding that, for whatever reason, it does not have the right to require the franchisees to purchase any new equipment that relates to the new technology. As further discussed below, a negative answer does not stop the franchisor’s initiative, but would most certainly change how the offer is presented and rolled out to franchisees. Set out below in Business Issues are some practical ways that franchisors can nonetheless seek to implement technological change.

2. **Does the franchisor have the right to require the franchisees to implement and use the technology?**

Depending on the nature of the new technology and the associated change it will have in the franchisees’ business, the franchisor must not only have the right in the franchise agreement to require franchisees to acquire the new technology, but the franchisor also needs the right to require the franchisees to implement any associated changes to the way they do business. While this question is related to the first question, and will involve much the same due-diligence exercise, it is without doubt a distinct issue. For example, the franchisor may need to ensure that it has the right to, depending on the nature of the technology, require the franchisees to establish and use new record-keeping systems, reporting systems or other back-office solutions. Alternately, if the technology will result in a change to the way that the franchisees offer and sell goods and services, the franchisor needs to ensure that it has the right to require franchisees to do so.

3. **Does the roll-out of the technology trigger a new disclosure obligation?**

Clearly, the cost of any equipment related to the new technology must be reflected in the chart of estimated costs of establishing the business in Item 7 of the FDD. Similarly, any change to the franchisor’s programs or standards must also be disclosed where described in other parts of the disclosure document.

Further, in Canadian provinces with franchise legislation, the franchisor must decide whether the technological change constitutes a “material change” for which it must issue a statement of material change to any prospective franchisees who have received the franchisor’s disclosure document but who have not yet signed a franchise agreement or paid any consideration. A full discussion of what constitutes a “material change” and a “material fact” is beyond the scope of this paper, but we raise the issue for a matter of completeness with respect to describing the legal considerations.
B. BUSINESS ISSUES

1. Why is the change being contemplated?

A fundamental question to consider from a business perspective is why the franchisor is implementing the change. Is it to respond to competitive pressures in local, regional or national markets? If so, is the franchisor positioning itself as the market leader and adopting untested technology, or merely playing catch-up to its better-positioned competitors. Is the change intended to drive profits or decrease expenses, or will it be a net cost to franchisees? Will the franchisor profit from the franchisees’ implementation of the change, either on a one-time or ongoing basis?

As a practical matter, the answer to these questions, and the contractual right of the franchisor to introduce the change as discussed in the forgoing section, will help determine how the franchisor will introduce the change to franchisees. Franchisors must be aware that the business justification for implementing system-wide changes has in the past been challenged by franchisees as being inconsistent with the franchisor’s obligation to act in accordance with the duty of good faith and fair dealing, even in the face of express contractual rights. Accordingly, franchisors must ensure that they consider the business rationale for the technological change, and that they have considered the impact on franchisees. This must also be well documented in order to provide any assistance in the face of a challenge.

This is especially important if the results of the franchisor’s due-diligence investigation into the legal issues has shown that the franchisor is not in a position to implement the change on a mandatory basis. In that case, the franchisor has to ensure that it has the franchisees’ buy-in of the change or face failure. As discussed below, franchisors still have some practical options to encourage franchisee buy-in in the event that a technology change cannot be implemented on a mandatory basis.

2. If the franchisor has the right to obligate franchisees to purchase and use the technology, will the franchisor still proceed?

Even if the results of the franchisor’s due-diligence investigation reveal that the franchisor can require franchisees to implement the change, the franchisor should nonetheless still consider whether it is wise to proceed. Simply put, if the franchisor faces a significant objection, or even litigation, by the franchisees due to the change, it may want to weigh the relative importance of the change against the time and cost of handing a dispute, even if the franchisor expects to be ultimately successful on the legal issues.

Clearly, franchisors can expect some objections to any proposed change – technology or otherwise – in an established system. It is simply not reasonable, or practical, to abort a proposed change merely on the basis of some anticipated disputes; that is

23 See, e.g., Carvel Corp., supra n.22.
inevitable. However, if the franchisor expects material and protracted objections on an organized basis, then it should carefully consider its approach to the implementation of the change (see below).

3. **If the franchisor does not have the right to require franchisees to purchase and use the technology, will the franchisor still proceed?**

Finding that the franchisor does not have the right to require all franchisees to implement the change on a mandatory basis does not necessarily end the franchisor's initiative, as there are still some practical options available.

The first option is to implement the change for those franchisees whose form of agreements permit the franchisor to do so. However, as a practical matter, this may be easier said than done. Depending on the nature of the new technology, the franchisor must consider whether a staggered implementation process is possible. In other words, can the franchisor's system manage a two-tier structure that would support both the franchisees who are using the new technology and those who have not adopted the change? A two-tier system may result in difficulties (including the cost of maintaining two systems) that could undermine or negate the benefit of implementing the change in the first place, unless the franchisor can ensure that the two-tier system will only be for a finite interim period until all franchisees are on the new system. For example, if the franchisor supports a centralized reservation system and has only partial buy-in from its franchisees for a migration to a new system, it may not be administratively or technologically possible to simultaneously support both systems.

If that is the case, the franchisor's options are to: (i) offer financing, discounts or other incentives in order to ensure 100% buy-in (recognizing that in a franchise system of any size, securing 100% buy-in would be a significant achievement); and/or (ii) develop a strategy that will result in the change becoming mandatory for all franchisees. One such strategy would be to change the franchisor's standard form of franchise agreement to expressly permit the change, then implement it on a one-by-one basis as franchisees renew their agreements and as new franchisees come on board the system. As noted above, this is a distant second-best option simply due to the time it would take to get all franchisees on the new form of franchise agreement. In such cases, franchisors may need to take a double-headed approach to the issue by incentivizing franchisees to adopt the new technology mid-term while also making it mandatory upon renewal.

4. **How will the new technology be received by franchisees?**

Gauging the franchisees’ reaction to the change in technology is a critical consideration regardless of whether the franchisor has the right to mandate the change for all of its franchisees. If the franchisor does have such a right, it should consider the franchisee’s reaction in order to determine whether there will be significant opposition, and that will help shape the franchisor's approach. If the franchisor does not have this right, then gauging the franchisees’ reaction will be required in order to determine the likelihood of successfully implementing a voluntary roll-out on a system-wide basis. As part of this exercise, the franchisor must consider the following issues:
(a) **How significant is the change being considered?**

The more material the change, the more likely it will raise associated issues (e.g., technology compatibility, cost, etc.). However, the franchisor must consider the materiality of the change from the franchisee’s perspective, even if it seems relatively straightforward to the franchisor. The materiality of the change will affect all of the considerations in this section.

(b) **How and when will franchisees be notified of the new technology?**

The timing of the notice to franchisees of an upcoming change is a challenging issue; if it is provided too early in the process, it could have the unintended effect of giving franchisees time to organize a coordinate opposition. Too late in the process will make franchisees feel that they have had no input (especially if it is true).

The change can be communicated to franchisees through the franchisor's usual channels (e.g., newsletter, email, intranet, etc.), though it is usually preferable to have the news delivered by a franchisee advisory council or association (discussed further below).

Also of critical importance is ensuring that the communication presents the change in the best possible light, including detailing the reasons for the change, why the franchisor believes that the chosen option is the best manner in which to proceed, how the change will resolve the issue, and the expected outcome (stopping short, of course, of providing any guarantees). Presenting a persuasive case for the change may stop franchisees from reaching for their franchise agreements to check to see whether the franchisor is within its rights to implement the change.

(c) **Will franchisees be involved with the planning of the new technology?**

This is a critical consideration for any franchise system as involving franchisees in the decision-making process can be the difference between a successful implementation and a protracted dispute. The earlier the better; even as early as deciding whether a technological change is needed in response to whatever challenge is facing the franchise system. Ideally, the franchisor would work with a franchisee advisory council to develop a roadmap for the introduction and implementation of the solution. Not only could the advisory council be able to provide practical suggestions, but the support by the council will likely help facilitate the implementation of the change to other franchisees. Further, some consultative process with franchisees can also assist the franchisor with any later dispute by disgruntled franchisees, including claim that it breached its duty of good faith by not taking the franchisees’ interests into consideration. In *In re Sizzler Restaurants International, Inc.*, the franchisee association’s support of a proposed change by the franchisor went a long way to show that the decision to implement the change was reasonable and not inconsistent it its
duty of good faith. While not related to technology, the principles of the decision can easily be applied in the context of a technological change.

(d) **How involved will the franchisees be with the new technology?**

The change may have little practical effect on the franchisee’s day-to-day operations (e.g., the change to a consumer-facing reservation system that is supported and operated wholly by the franchisor).

(e) **Is the technology compatible with the franchisee’s existing systems (i.e., are all franchisees currently on the same system)?**

Implementing technological changes in a franchise system poses unique challenges than other kinds of changes (e.g., a new product offering). Older franchise systems may have franchisees with various computer systems which does not allow the franchisor the luxury of having a single starting point. Franchisors wishing to upgrade – as opposed to replace – computer systems may face significant challenges in mating new technology with old. In such cases, it may simply be impractical to try to develop software that will work with all systems, and the franchisor may need to require franchisees to replace their existing computer systems in addition to implementing the new change. Any increase in the cost associated with the change is bound to have a corresponding increase to the resistance by franchisees to the change.

(f) **Have there been recent significant changes to the franchise system (including non-technological changes)?**

Similarly, is this a stand-alone change or part of a bigger project? The change may be a harder sell if it closely follows, or will be followed by, any other change, especially one that was also disputed by franchisees.

(g) **Will the technology be offered on an optional or mandatory basis?**

As discussed above, simply because the franchisor has the contractual right to require adoption of the change by franchisees does not mean that the franchisor has to introduce the change on a mandatory basis. To facilitate the change, the franchisor may wish to implement it on an optional basis, with incentives for early adopters.

(h) **Have there been disputes in the past regarding changes to the franchise system?**

If so, learn from past mistakes and take extra care to address potentially contentious issues.

(i) **Will the franchisor offer any limited-time subsidies, financing or other incentives?**

Incentivizing early adoption can help build momentum. Franchisors should consider sweetening the deal by offering subsidies, financing and other incentives to franchisees who adopt the new technology, particularly if the franchisor does not have the right to mandate the change for all franchisees. If the franchisor does have the right to mandate the change, it still has the option to offer the change on an optional basis, with incentives, but clearly communicate to franchisees that it once the optional period is over, a mandatory phase-in period, without incentives, will begin.

(j) **How is the franchisor otherwise supporting the change?**

In the example of a franchisor wishing to discontinue an outdated system, the franchisor could support the change by (i) offering a discount in royalty fees or other monthly fees in exchange for the reduced service, and (ii) arranging for an alternate third party to provide the services.

5. **How will the franchisor implement the roll-out?**

Regardless of whether the franchisor has the right to require the franchisees to adopt the change, the franchisor should consider how to best roll out the new technology in a manner that best suits the circumstances, including:

(a) **Should the franchisor conduct a limited roll-out on a trial basis in advance of a full-scale roll-out?**

Unforeseen problems arising during a field trial can be isolated and addressed more easily than if the technology has already been adopted on a system-wide basis. Perhaps more importantly, any damages arising from a problem with the software during a trial will likely be limited and can be isolated and corrected with relative ease. A trial is especially important if the technology (e.g., a software upgrade) has been customized by the vendor for the franchisor’s system, as opposed to an off-the-shelf software program that doesn’t need to be integrated with the franchisor’s or franchisee’s systems. Of course, as discussed above, it may not be possible to conduct a partial roll-out, for example if the franchisor’s systems cannot simultaneously support new and old technology.

(b) **Will the technology be implemented in corporate stores first, or at the same time as the franchisee roll-out?**

A trial roll-out at the franchisor’s corporate locations could demonstrate good faith and buy-in for the system from the franchisor. Further, any problems with the technology that arise at the corporate stores can be managed more efficiently (and without the threat of damages) than at franchisee locations.
(c) Will the roll-out be conducted in staggered phases?

The technological change may require significant oversight by the franchisor’s personnel, including coordinating with franchisees for ordering, installation and training. As a result, it simply may not be possible to implement the change on a system-wide basis on a single date. In that case, the franchisor must consider how best to stagger the roll-out, including whether to organize it according to (i) geography, (ii) franchisees volunteering (incentivized or not) to participate, and/or (iii) franchisees’ current systems. Additionally, the franchisor’s ideal roll-out period may be subject to the capacity of the supplier to produce sufficient products.

If the change will be largely managed by the franchisor locally (e.g., a centralized reservation system that is hosted by the franchisor or by the franchisor’s service provider), then a staggered roll-out may not be necessary or desirable.

(d) What will customers experience during the roll-out?

Given the nature of franchise systems, ideally customers will experience seamless service from all franchisees. Franchisors must balance the benefits of a staggered roll-out with the any damage to the brand and the goodwill if the staggered roll-out will result in inconsistent service, or worse, poor customer service.

(e) Will new training be required? If so, how will that be offered?

Generally speaking, changes to computer software and hardware systems (e.g., ordering systems, point-of-sale cash systems, franchisee intranets and similar systems) are not developed in-house by the franchisor (though some are). Training is offered by the developer at additional cost, and the franchisor must decide how to best provide training (e.g., local group meetings, by-your-side training, internet videos and tutorials, written materials, etc). Whether the cost will be passed on to the franchisees by the franchisor will likely depend on whether the franchisor has the right to implement the change.

6. If the technology change is implemented on a mandatory basis, how will the franchisor deal with holdouts?

Even in a best-case scenario, with a clearly worded franchise agreement and support from a franchisee council or association, a franchisor can expect to have to deal with some franchisees who object to a change to existing technology. Presuming that the number of objecting franchisees is fairly low (otherwise, consider some of the suggestions set out above), the franchisor must have a plan to deal with these holdouts. In some cases, due to the nature of the change, the outcome may be inevitable, for example that the franchisee is unable to use and benefit from a new system or program. In other cases, the franchisor must determine the best course of action, including: (i) delivering the system and invoicing the franchisee; (ii) delivering a default notice; and/or (iii) withholding services related to the new technology. In all cases, the
availability of these options will again depend on the wording of the franchise agreement and be carried out in accordance with the franchisor’s duty of good faith.

7. **How will the franchisor deal with any glitches in the roll-out?**

In a perfect world, the new technology integrates perfectly with existing systems, operates as intended and yields the desired results. Back in the real world, franchisors implementing new technology must plan to deal with glitches in the roll-out and operation of the new technology. These could arise with franchisees, such as unfamiliarity with the system that can be corrected by additional training, or with the system itself, in which case the franchisor must have an emergency back-up plan in the event of a system failure. Planning to deal with these glitches starts all the way back at the initial development stages; the franchisor should ensure that the agreement with its developer/supplier provides for training and support of franchisees, and include service response requirements to deal with any critical system problems. Franchisors should also consider adding indemnity provisions in the development agreement to protect against claims against the franchisor by franchisees.

Franchisors have a number of issues to consider when implementing technological change, whether on an optional or mandatory basis. Careful planning and involvement of franchisees early in the process could make the difference between a successful implementation and a class-action lawsuit.

V. **E-DISCLOSURE**

The speed and convenience of electronic communication has long since made it the preferred method of written communication for individuals and businesses, yet franchise legislation has lagged in recognizing that physical delivery of documents is no longer favoured by either franchisors or franchisees. This part of the paper addresses the options, risks and traps faced by franchisors who want to use e-disclosure of their FDD.

A. **UNITED STATES**

When the FTC amended the Franchise Rule in 2007, it erased any doubt that may have lingered about whether e-disclosure was permitted. In its Statement of Basis and Purpose, published with the newly-amended Franchise Rule, the FTC was very straightforward:

“[T]he final amended Rule also promotes efficiency and reduces compliance costs by enabling franchisors to use their own judgment in deciding how to disseminate disclosure documents. For example, part 436 permits franchisors to furnish disclosures electronically through a
variety of media, including CD-ROM, Internet website, and email.”

The rules for providing e-disclosure are burdensome, although an analysis of this topic involves looking at more than just the FTC Rule.

1. **Background**

On June 30, 2000, President Clinton signed into law the Millennium Digital Commerce Act, known as the “E-SIGN” Act. The E-SIGN Act pre-empted almost all state and federal laws and regulations that limited use of electronic signatures, agreements, or records. Although E-SIGN did not mandate that contracts and disclosures be provided electronically, it eliminated the barriers to doing so. In a memorandum to agencies of the Executive Branch of the U.S. Government, the Director of the Office of Management and Budget explained the new law and provided OMB’s guidance on complying with its requirements. The Director wrote that:

> Many Federal, State, and local laws or rules require that parties receive notices and disclosures in connection with private transactions (for example real estate purchases and settlements). To the extent these laws or rules require paper notices, E-SIGN largely supersedes them.

2. **How We Got Here**

To understand the legal issues relating to e-disclosure, one needs to consider the background that led to today’s certainty.

Before it adopted the 2007 amendments to the Franchise Rule, the FTC took steps toward permitting – but yet still regulating – electronic disclosure. The process, while ultimately clarified, sowed some degree of confusion for close to a decade.

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28 Jacob Lew, Memorandum for the Heads of Departments and Agencies, Office of Management and Budget (Sept. 25, 2000) (available at www.whitehouse.gov/omb/memoranda/m00-15.html). Special requirements apply to “consumer” disclosures under E-SIGN. Thus arises the inevitable question as to whether the “consumer” provisions of E-SIGN apply to franchise transactions. Fortunately, the Act contains a definition that resolves the question. Under E-SIGN, franchise transactions are not deemed consumer transactions, because the Act defines the term “consumer” in its ordinary meaning: “an individual who obtains, through a transaction, products or services which are used primarily for personal, family, or household purposes.” 15 U.S.C. § 7006(1). See also Staff Report, infra note 33, at 195.
1997 *Staff Advisory Opinion*. An FTC staff advisory opinion in 1997 addressed whether a franchisor could provide its disclosure document (then, a UFOC) to a prospective franchisee on a computer diskette.\(^{29}\) While staff agreed that disclosure could be provided electronically, it expressed concerns as to details such as compatibility with the recipient’s computer (remember “Commodore” and “Atari” computers?), whether the UFOC would be presented in a single read-only document, whether the prospect could ask for a paper copy, and whether the prospect could retain the document. The FTC staff also opined that the disk should bear a label identifying the franchisor and noting that the disk included the UFOC.

1999 *Notice of Proposed Rulemaking*. When the FTC issued its Notice of Proposed Rulemaking (NPR) in 1999, it proposed adding a new subsection 436.7 to the Franchise Rule, which would have permitted and regulated e-disclosure.\(^{30}\) While 436.7 was not ultimately adopted, the approach taken by the FTC suggested a course of action that other players (specifically, the states and NASAA) took in addressing the same issues.

*July 2000 Demonstration Project*. In an ironic twist of timing, while attempting to advance its embrace of e-disclosure, the FTC inadvertently caused some confusion in this area. Just three weeks after the President signed the E-SIGN Act into law, the FTC published a notice in the Federal Register in July 2000, soliciting comments on a proposal that would allow e-disclosure but only for a specific demonstration project and subject to certain restrictions.\(^{31}\)

Almost five years later, the FTC staff formally clarified in the Staff Report (discussed below) that its position taken in the NPR was preempted by the E-SIGN Act. However, not long after the July 2000 demonstration project announcement, the FTC staff informally announced its approval of several additional demonstration projects. Each time, the FTC staff realized that it might have to change its approach to e-disclosure in light of E-SIGN, but nonetheless suggested that franchisors seeking to provide e-disclosure should follow the requirements of proposed subsection 436.7 of the NPR.\(^{32}\)


\(^{31}\) 65 Fed. Reg. 44484-85 (Jul. 18, 2000). The FTC staff later gave informal approval to several other demonstration projects.

\(^{32}\) See Informal Staff Advisory Opinions 01-3 (Nov. 29, 2001), 03-3 (Jun. 24, 2003), 03-5 (Dec. 3, 2003), and 05-4 (Aug. 30, 2005). In Informal Staff Advisory Opinion 05-4, the FTC staff wrote that “[i]n light of E-SIGN, the Commission may rethink the proposed Rule's electronic disclosure instructions. Indeed, the 2004 Staff Report on the Franchise Rule recommended several revisions that would streamline those instructions. While the Commission considers the Rule amendment record and the Staff Report's recommendations, we recognize that the franchise community continues to need guidance on electronic disclosure. We still believe that the best advice we can offer at this time is for franchisors interested in Internet disclosure to follow the procedures outlined in the NPR until such time as the Commission
August 2004 Staff Report. The FTC Staff finally took a position on E-SIGN’s impact on e-disclosure when it issued the August 2004 “Staff Report to the Federal Trade Commission.” Among other things, Staff reflected upon the NPR and proposed subsection 436.7, which would have regulated e-disclosure. Instead, the 2004 Staff Report concluded that:

On June 30, 2000, Congress enacted The Electronic Signatures in Global and National Commerce Act (“E-SIGN”). E-SIGN seeks to eliminate barriers to e-commerce by, among other things, giving legal effect to electronic transactions, including pre-sale disclosure, and permitting electronic signatures. Further, E-SIGN also preserves certain consumer rights. Specifically, it provides that consumers must give their informed consent before engaging in electronic transactions and requires companies to disclose any rights consumers may have to receive paper records and to withdraw previously-given consent to receive electronic records. E-SIGN, however, limits such rights to “consumer” transactions, which it defines as an “individual who obtains, through a transaction, products or services which are used primarily for personal, family, or household purposes.” Thus, by its terms, E-SIGN may have rejected restrictions such as those proposed in the NPR for electronic franchise disclosure.

In light of E-SIGN, the staff has reconsidered the NPR proposals. As explained below, we recommend that the Commission eliminate the NPR’s proposed electronic disclosure instructions (NPR section 436.7). In lieu of specific electronic disclosure instructions, we recommend that the Commission broaden the proposed revised Rule’s general instructions (NPR section 436.6) to cover the furnishing of all disclosure documents, paper and electronic alike. Below we set forth our recommendations for a single, expanded general instructions section, incorporating comments submitted on the original NPR proposals (proposed revised section 436.6).

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33 That document, issued online, is available at the FTC’s website, at http://ftc.gov/os/2004/08/0408franchiserulerpt.pdf (the “Staff Report”).

34 Staff Report at 210 (footnotes omitted).
In January 2007, when it issued the amended Rule, the FTC adopted the approach suggested in the Staff Report. The amended FTC Franchise Rule confirms that there are no barriers to providing disclosure in franchising. Although the FTC adopted provisions that relate to how disclosure can be provided - and while other commentators can debate whether even those limited provisions are permitted under E-SIGN – these portions of the amended Rule do not pose a significant practical barrier to e-disclosure.

Moreover, the language quoted above from the Staff Report was substantially repeated in the SBP, where the Commission itself confirmed clearly that the process for providing disclosure is the same whether the franchisor provides disclosure in paper or electronic format.35

3. How to Provide E-Disclosure under the Amended FTC Rule

The FTC intentionally adopted guidelines – rather than specific standards – for providing e-disclosure. In doing so, the Commission astutely recognized that new technologies are inevitable and will change how parties can – and prefer – to exchange documents such as an FDD. Moreover, as the general population of our country grows more comfortable with the electronic exchange of all kinds of information, over time, that comfort level will extend evenly, or perhaps even more so, into the ranks of people as innovative as franchisors and prospective franchisees. Therefore, new electronic disclosure methods are to be expected, and fortunately, the amended Rule will not hem them in.

In practical terms, there are four requirements for providing e-disclosure under the amended FTC Rule:

(a) Pre-Disclosure Notification

Section 436.6(g) of the Rule requires franchisors, before they furnish the disclosure document, to advise the prospect of several points: (i) the formats in which the disclosure document is made available; (ii) any prerequisites for obtaining the disclosure document in a particular format; and (iii) any conditions necessary for reviewing the disclosure document in a particular format. In practical terms, because a franchisor must disclose this additional information before it provides its FDD, a good place to do so might be the franchise application form, an online screen, or an e-mail. An example of this disclosure might read: “We will send you our FDD as an attachment to an e-mail. You will need to have a computer and an e-mail address that can receive an e-mail with a 3MB attachment. Receiving our FDD may take long unless you have a broadband

35 “In light of E–SIGN, the Commission has reconsidered the Franchise NPR proposals. As explained below, the final amended Rule eliminates the Franchise NPR’s proposed electronic disclosure instructions - Franchise NPR section 436.7. In lieu of specific electronic disclosure instructions, the final amended Rule contains a broad general instructions section that covers the furnishing of all disclosure documents, paper and electronic alike.” SBP at 72 Fed. Reg. 15512.
connection. You also need a copy of “Adobe Reader,” which you may already have on your computer, or which you can download for free at [www.adobe.com/products/acrobat/readstep2.html]."

(b) Delivery

Franchisors must prepare and deliver the FDD in one simple file, without any extraneous information, such as external hyperlinks. Internal navigation links (e.g., a hotlink from the FDD’s table of contents directly to the page on which Item 11 can be found) will, however, be permitted. The FDD should be prepared in a format such as “PDF” (portable document format) – so that the document can be read by the prospect in the same format as it was prepared by the franchisor, without regard to what kind of computer the prospect uses or what software was used to create the content. Delivery can be accomplished in any manner – such as by e-mail, downloading from a website (e.g., one run by the franchisor or one operated by a commercial service), or in a physical medium (e.g., on a CD or a thumb drive).

(c) Proof

Because the FTC Rule requires franchisors to retain a signed receipt for each franchise agreement, the franchisor must be able to prove that it delivered its FDD to a prospect that actually signed an agreement. The FTC has, wisely, left it up to the parties to determine what constitutes proof:37

As an initial matter, franchisors always have the burden of proof to show that they have complied with the Rule’s obligation to furnish disclosures. We also believe that the Rule should be as flexible as possible, allowing franchisors to keep records and to offer proof, in the format that is most convenient to them.38

There are various methods of obtaining a receipt.

One would be to ask the prospect to open the FDD, print out the last page (the receipt), sign and date the receipt, and send it back to the franchisor (perhaps by fax).

A second would be to create an outside link to a plain-vanilla webpage with no information or outside links other than the text of an Item 23 receipt (for consumer education purposes) and spaces in which the recipient can provide information to confirm that she or he received the FDD on a particular date. Although this seemingly defies the no-external-hyperlinks rule noted above, that rule is intended to prevent

36 Section 436.6(d). But see the discussion of receipts, below.

37 See Section 436.5(w), and SBP at 72 Fed. Reg. at 15471-72 (n. 280) and 15512-13.

38 SBP at 72 Fed. Reg. at 15471-72 (n. 280).
introduction of extraneous information into the FDD. A link to a page at which there is no information other than an electronic copy of the receipt page, and no link to the franchisor's webpage, is consistent with the regulatory goal of keeping out extraneous information, and also with the Commission's goal of allowing parties to choose the most efficient way to provide disclosure and obtain receipts. Just as importantly, E-SIGN specifically eliminated most statutory and regulatory barriers to electronic verifications and acknowledgements of receipt. The FTC Staff acknowledged in its online FAQs that this proposed method of providing disclosure is acceptable.

However, the Commission made clear that other methods for obtaining receipts may also be available:

Item 23 is flexible, affording franchisors and franchisees greater latitude in demonstrating receipt than the comparable UFOC Guidelines provision. Whereas UFOC Item 23 requires franchisors to acknowledge receipt with a handwritten signature, Item 23 updates the Rule by allowing the parties to use electronic acknowledgments of receipt. As discussed in the definitions section above, the term “signature” includes not only written signatures, but electronic signatures, passwords, security codes, and other devices that enable a prospective franchisee to easily acknowledge receipt, confirm his or her identity, and submit the information to the franchisor. [footnote 691]

[footnote 691: “Item 23 also provides that franchisors may include specific instructions on how prospects should submit the receipt, such as via facsimile or email. This enables the parties to determine for themselves the most efficient and cost-effective way for the prospective franchisee to transmit the acknowledgment.”]

(emphasis added).

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40 See the FTC’s website for “Amended Franchise Rule FAQ's” and, in particular, FAQ #15 (www.ftc.gov/bcp/franchise/amended-rule-faqs.shtml#15).

41 72 Fed. Reg. at 15512-13 and n. 691.
Indeed, the term “signature” under Section 436.1(u) of the FTC Rule is fairly broadly defined:

Signature means a person’s affirmative step to authenticate his or her identity. It includes a person’s handwritten signature, as well as a person’s use of security codes, passwords, electronic signatures, and similar devices to authenticate his or her identity.

The FTC Rule requires franchisors to obtain and retain (as noted below) as “signed receipt” – and in the SBP, the Commission made clear that its definition of the term “signed” was to be broadly interpreted to accommodate current and newly-developed technologies.

Finally, we note that for the purpose of proving a pattern of compliance, it is helpful – although not required – for a franchisor to be able to prove that it sent an FDD even to prospects that did not ultimately sign an agreement. This may be particularly important if a franchisor must respond to an investigation by the Federal Trade Commission staff or a state regulator seeking to determine whether the franchisor made proper efforts to comply with the Franchise Rule or state law. While a signed receipt is obviously the best evidence of such efforts, other methods may also be helpful in this regard (e.g., copies of transmittal letters and e-mails, as well as electronic messages generated from a website confirming that a prospect downloaded an FDD).

(d) Recordkeeping

Under Sections 436.6(h) of the FTC Rule, franchisors are required to keep a copy of each materially different version of their FDD, and under Section 437.6(i), they are required to keep a “signed receipt:” for each completed franchise transaction, for at least three years. The Commission observed that many states impose similar (if not more stringent) requirements, and also that franchisors usually keep similar records as a matter of prudent business practice. Indeed, under NASAA’s Model Rule, adopted in California and Indiana, the franchisor must be able to prove receipt or its original authority to send disclosure electronically is (in effect, retroactively) ineffective.42

B. CANADA

Franchise matters in Canada are regulated at the provincial level; there is no national rule regulating franchising. Currently, only four Canadian provinces (Ontario, Alberta, Prince Edward Island and New Brunswick) have franchise legislation in force (Manitoba

42 Cal. Code Regs, tit. 10, § 310.114.4(a)(3), available at Bus. Franchise Guide (CCH) ¶ 5050.24; Indiana Statement of Policy Regarding Electronic Delivery of Franchise Disclosure Documents, available at Bus. Franchise Guide (CCH) ¶ 5140.06. This paper does not analyze whether these state regulations are too broad to pass muster under the E-SIGN Act, but that is clearly a possibility that the FTC itself recognized when it abandoned its own attempt to regulate e-disclosure.
has passed legislation, but it has yet to come into force), and the approaches to electronic disclosure vary by province. In some cases, the difference is significant.

1. **Prince Edward Island**

In Prince Edward Island, the regulation made under the Franchises Act expressly permits a disclosure document to be delivered by electronic means. The legislation also sets out certain requirements, specifically that the disclosure document: (i) is delivered as a single, integrated document or file; (ii) has no extraneous content beyond what is required by law other than access and document manipulation tools; (iii) has no links to or from external content; (iv) is delivered in a form that lets the recipient store retrieve and print the document; and (v) conforms in content and form to the disclosure requirements of the province’s franchise legislation. In addition, a franchisor must keep a record of the electronic delivery of the disclosure document and receive a written receipt by the prospective franchisee.

Accordingly, franchisors offering franchises in this province have the benefit of clear and unambiguous rules relating to electronic disclosure.

2. **New Brunswick**

In New Brunswick, a disclosure document may be delivered by electronic means. Similar to Prince Edward Island, there are certain requirements, namely that the disclosure document must be delivered in a form that enables the recipient to view, store, retrieve and print the disclosure document, and contains no links to or from external documents or content. If a disclosure document is delivered by electronic means and consists of separate electronic files, the disclosure document must contain an index listing the file name for each file. If the file name is not sufficiently descriptive of the subject matter dealt with in the file, a statement of that subject matter must also be included in the index.

3. **Alberta**

The legislation in Alberta is unique in Canada in that it is silent on the method of delivery of the disclosure document. Accordingly, franchisors are free to elect how they choose to deliver the document to franchisees in Alberta. However, as a matter of best practices, should a franchisor elect to deliver a disclosure document electronically, it should follow the requirements in Prince Edward Island’s legislation.

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43 Prince Edward Island Regulation under the *Franchises Act*, Section 2(b).

44 New Brunswick Disclosure Regulation under the *Franchises Act*, Section 3(1)(b).
4. **Ontario**

(a) **Can the Disclosure Document be Delivered Electronically?**

Section 5(2) of Ontario’s *Arthur Wishart Act* (Franchise Disclosure), 2000 (the “Wishart Act”) sets out the methods for delivering the disclosure document to franchisees in the province. The section provides that the disclosure document may be delivered in person, by registered mail, or by any other prescribed method. No methods are currently prescribed.

Note that this section of the legislation does not include any reference to the delivery of a disclosure document by email or another electronic medium. Contrast this to the legislation in Prince Edward Island and New Brunswick, both of which expressly permit delivery by electronic means or in machine-readable media.

Accordingly, delivering the disclosure document electronically could result in a finding that the disclosure document had not been delivered at all, resulting in a rescission remedy for the franchisee. Given this risk of rescission, franchisors should not deliver the disclosure document electronically.

(b) **Can the Disclosure Document be Delivered in Electronic Form?**

If a franchisor cannot deliver the disclosure document electronically, can the franchisor nonetheless deliver the document in electronic (e.g., machine-readable) form, such as a CD or DVD (on the assumption that the CD or DVD itself would be delivered in person or by registered mail)?

While there is no express provision in the Wishart Act permitting the delivery of the disclosure document in machine-readable form, note that Section 5(2) of the Wishart Act addresses only delivery requirements and does not expressly address the format (e.g., on paper or in machine-readable media) in which the disclosure document must be delivered. The Wishart Act does not expressly require the disclosure document to be in paper format.

Ontario’s *Electronic Commerce Act*, 2000\(^{45}\) permits documents that are required to be provided in writing to a person to be provided in an electronic format, subject to certain requirements. Sections 3 and 4 of the E-Commerce Act require that the recipient must consent to the delivery of the document in electronic format. This consent need not be express, and instead may be implied by the recipient’s conduct, if it is reasonable to believe that the consent is genuine and related to the particular information being provided. Further, Section 6(1) of the E-Commerce Act states that, “A legal requirement that a person provide information or a document in writing to another person is satisfied by the provision of the information or document in an electronic form that is [...] accessible by the other person so as to be usable for subsequent reference; and

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\(^{45}\) S.O. 2000, c. 17 (the “E-Commerce Act”).
“capable of being retained by the other person.” This means that the person providing the document should ensure that the recipient has the capability to read, print and store the document. Also, note that Section 9 of the E-Commerce Act expressly states that an electronic document is not “capable of being retained” if the person providing the document does anything to “hinder or prevent” its printing and storage by the recipient. Accordingly, the person delivering the disclosure document cannot make it time limited or otherwise subject to any kind of expiration date.

Provided that a franchisor receives a prospective franchisee’s consent to receive the disclosure document on CD or DVD, the franchisee has the means to access and print the disclosure document, and the disc is delivered either personally or by registered mail, there are strong arguments that the delivery of an Ontario disclosure document on disc would satisfy the requirements under the Wishart Act. However, this position is not without some risk, simply because the Wishart Act does not expressly provide for the delivery of a disclosure document in machine-readable media, compared to the legislation in Prince Edward Island, for example, which expressly addresses this issue.

The risk of rescission may outweigh the advantages in efficiency and reduced cost of delivering a disclosure document on CD or DVD, and franchisors not willing to assume this risk should continue to provide a paper copy of the disclosure document.

Changing technology presents unique challenges and opportunities for franchisors, as technology plays a role in virtually all franchise systems; from a franchisee intranet, back-end royalty reporting software, accounting or ordering systems, to customer-facing point-of-sale cash register systems and reservation systems. It connects both franchisees and consumers, and franchisees with their franchisors. Franchisors must balance their efforts to keep pace with changing technology against possible damage to franchisee relationships by changing too much too fast.