

International Franchise Association
56th Annual Legal Symposium
May 5-7, 2024
Grand Hyatt Washington
Washington, DC

**Marketing Funds and Local Marketing
Do's and Don'ts to Promote System Harmony
while Promoting the Brand**

**Mark Dady
Dady and Gardner, P.A.**

**Marisa Faunce
Plave Koch PLC**

**Tanja Hens
Davis Wright Tremaine LLP**

**Gerry Wells
Rita's Franchise Company, LLC**

TABLE OF CONTENTS

I.	INTRODUCTION	1
II.	LEGAL FRAMEWORK	2
	A. The FTC Franchise Rule	4
	B. State Law and Regulations	10
III.	FRANCHISOR ADMINISTRATION OF MARKETING FUNDS.....	12
	A. Permitted Uses under the Franchise Agreement	12
	B. Marketing Fund Contribution Issues.....	16
	C. Administration of Marketing Funds with Multi-Brand Issues	20
	D. Franchisee Advertising Advisory Councils	21
	E. Promotions that Impact Franchisees and Other Sources of Disputes with Franchisees.....	23
IV.	LOCAL MARKETING	25
	A. Local Marketing Parameters	25
	B. Franchisor Approval and Control of Local Marketing Materials	28
	C. Responsibility for Compliance with Applicable Law.....	29
	D. Local and Regional Cooperatives	30
V.	CONCLUSION.....	33

I. INTRODUCTION

Most consumers today rely on trademark branding used in modern business advertising and merchandising to make purchasing decisions. Trademarks are the cornerstone of franchise brands and franchisors and franchisees alike rely on consumer familiarity with the brand to drive sales, making advertising a critical feature of a successful franchise system. As franchising has expanded over the past 80 years, franchisors have recognized the value of pooling money from their franchisees and their company operations into a centralized Marketing Fund to produce advertising materials for use by the system. No matter the industry, one almost universal constant in franchising is a requirement that franchisees contribute money to a Marketing Fund to be used for marketing and other purposes to promote the brand.

The pooling of funds for marketing enables franchisees to focus on the operation of their businesses while the experts create marketing materials that can be placed by the franchisor on a national, regional or local level. Franchisees can also tailor the specimen materials created by the Marketing Fund for their individual use on a local level. This approach enables the franchise system to present a cohesive marketing strategy to the consumer, which, in turn, drives familiarity to the brand and ultimately helps to increase sales. Given that these contributions to a franchisor's Marketing Fund can be a significant expense to franchisees and, unfortunately, a significant source of friction between franchisees and franchisors, issues surrounding these funds have become more common now than ever before.

In addition to Marketing Funds, franchisors employ a variety of tactics to promote consumer awareness of their brands. Regional marketing funds administered by the franchisor and marketing cooperatives run by the franchisor-owned and franchisee-owned outlets in a region can effectively drive traffic to the system outlets by focusing on local marketing messaging. Additionally, requiring franchisees to conduct ongoing local marketing initiatives, overseen or reviewed by the franchisor for consistency, helps to keep the presence of the local outlet known to the consumer.

This paper examines the legal framework surrounding Marketing Funds, examines Marketing Fund usage by several brands, and addresses local marketing requirements in use by many franchise systems. Franchise system Marketing Funds are referred to by different names in franchise agreements and franchise disclosure documents ("FDDs") including "marketing fund,"¹ "branding fund,"² and "advertising fund"³. For consistency,

¹ Qdoba Franchisor, LLC Franchise Disclosure Document (December 22, 2023), available at https://www.cards.commerce.state.mn.us/documents/%7BC0FD8F8D-0000-C417-9087-9222AA58AEDC%7D/download?documentClass=FRANCHISE_REGISTRATIONS&contentSequence=0 (last visited March 28, 2024) ("Qdoba FDD"), at Page 28.

² Rita's Franchise Company, LLC Franchise Disclosure Document (January 30, 2023), available at https://www.cards.commerce.state.mn.us/documents/%7BB0C2D07F-0000-C6E5-A98F-809DE12BC26A%7D/download?documentClass=FRANCHISE_REGISTRATIONS&contentSequence=0 (last visited March 28, 2024), Page 33.

³ Culver Franchising System, LLC Franchise Disclosure Document (March 30, 2023), available at https://www.cards.commerce.state.mn.us/documents/%7B107CA087-0000-C1F0-AC70-BDFEA9734A39%7D/download?documentClass=FRANCHISE_REGISTRATIONS&contentSequence=0 (last visited March 28, 2024) ("Culver FDD"), at Page 27.

these funds will be referred to as “Marketing Funds” throughout this paper (unless the context requires otherwise).

II. LEGAL FRAMEWORK

Advertising is regulated by a number of state and federal laws that are designed to protect consumers from false, deceptive and unfair advertising practices. For example, Section 45(a) of the Federal Trade Commission Act of 1914 (the “FTC Act”) prohibits “unfair or deceptive acts or practices in or affecting commerce.”⁴ In the advertising context, this generally means that an advertisement must be truthful and not misleading, and that advertisers must have evidence to substantiate the claims that they make.⁵ State unfair and deceptive trade practices statutes generally prohibit unfair and deceptive marketing.⁶ In addition, Section 43(a) of the Federal Trademark Act (“Lanham Act”) ⁷ prohibits false and deceptive advertising in connection with use of a trademark, name, or symbol.⁸

The passage of the Lanham Act in 1946 enabled trademark owners to protect their trademarks when used by manufacturers, distributors, and licensees as long as the owner exercised sufficient control over the “nature and quality” of the licensee’s finished products and activities to assure the public that the licensee’s goods and services were the same nature and quality originally associated with the trademark.⁹ Licensing factors into the extensive use of trademarks in the United States today and is an integral part of franchising where a local operator can take advantage of consumer demand for products that are connected to a well-known logo or brand name.¹⁰ Indeed, “the cornerstone of a franchise system must be the trademark or trade name of a product.”¹¹

In 1978, the Federal Trade Commission (“FTC”) promulgated the Franchise Rule¹² (“FTC Franchise Rule”) to protect franchisees from unscrupulous behavior by

⁴ 15 C.F.R. §45 (1914). The Federal Trade Commission was created in 1914 under the FTC Act and opened its doors in 1915 with a mission to “protect consumers and promote competition.” <https://www.ftc.gov/enforcement>. Other federal laws regulating advertising include the Communications Act (47 U.S.C. §151 *et seq.*), the Telephone Consumer Protection Act (TCPA) (47 U.S.C. §227), Controlling the Assault of Non-Solicited Pornography and Marketing Act (“CAN-SPAM Act”) (15 U.S.C. §§7701-7713), and the Food, Drug and Cosmetic Act (“FD&C Act”) (21 U.S.C. §§301-399) See, e.g., Annie P. Caiola and Paul F. Woody, *Advertising for Franchise Systems*, ABA 45TH ANNUAL FORUM ON FRANCHISING W-20, 2-6 (2022). A detailed discussion of federal and state advertising laws is beyond the scope of this paper – see Caiola and Woody for more information.

⁵ See Caiola and Woody at 2.

⁶ *Id.* at 7.

⁷ 15 U.S.C. §§1051 *et seq.*

⁸ 15 U.S.C. §§1125(a)(1)(A) and (B). To comply with the FTC Act, state unfair and deceptive trade practices acts, the Lanham Act, and other advertising laws, franchisors and franchisees should follow the “Five Golden Rules of Advertising” in their marketing activities: (1) claims must be truthful and non-deceptive; (2) claims must be fair; (3) all claims and reasonable interpretations must be substantiated; (4) extra caution should be used with claims directed to certain groups (e.g., children, elderly, etc.); and (5) be aware of specific laws governing specialized avenues of sale and advertisement. See, e.g., Jennifer B. Moore and Linda K. Stevens, *Avoiding False Advertising Claims*, ABA 29TH ANNUAL FORUM ON FRANCHISING, W-2, 6-12 (2006).

⁹ *Susser v. Carvel Corp.*, 206 F. Supp. 636, 641 (S.D.N.Y. 1962), *aff’d*, 332 F. 2d 505 (2d Cir. 1964).

¹⁰ *Id.*

¹¹ *Id.* at 640.

¹² Federal Trade Commission Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures 16 C.F.R. §436 (1979). The FTC amended the FTC Franchise Rule in 2007. 16 C.F.R. §§436, 437 (2007).

disreputable franchisors that were using “false or unsubstantiated earnings claims to lure prospective purchasers into buying a franchise. . .”.¹³ The FTC Franchise Rule’s definition of a “franchise” highlights the key interdependence of a brand’s trademark to the consumer’s perception of a “chain” of businesses:

- (1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor’s trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor’s trademark;
- (2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee’s method of operation, or provide significant assistance in the franchisee’s method of operation;¹⁴ and
- (3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.¹⁵

Modeled after the securities laws, the FTC Franchise Rule requires pre-sale disclosure of material terms of the franchise relationship through a detailed FDD and identifies 23 items that must be addressed in the FDD. These items cover the franchisor, its affiliates and predecessors, officers, directors and managers; franchisor bankruptcy and litigation history; the franchise agreement and related fee structure; the initial investment required to purchase a franchise; suppliers and supply chain details; financing; training; computer systems and technology; advertising; trademarks, copyrights and patents; financial performance representations; audited financial statements covering the prior three years; and a three year summary of the number of outlets in the franchise system.¹⁶ An FDD must follow the format set forth in the FTC’s Franchise Compliance Guide (“FTC Compliance Guide”).¹⁷ In addition, franchisors that plan to sell franchises in the fourteen states with franchise registration and disclosure laws (“Registration States”)¹⁸ must comply with the North American Securities

¹³ Statement of Basis and Purpose, 72 Fed. Reg. 15,445, 15,445 (Mar. 30, 2007).

¹⁴ As part of its detailed discussion of each of the three elements of the FTC Franchise Rule’s definition, the FTC’s Franchise Compliance Guide identifies “promotional campaigns requiring franchisee participation or financial contribution” as an example of “significant control” and furnishing marketing advice and systemwide networks and websites as examples of “significant assistance,” which highlights the importance of marketing to a franchise system. FTC, *Franchise Rule Compliance Guide*, Bus. Franchise Guide (CCH) ¶6,086 (2008), available at <http://www.ftc.gov/system/files/documents/plain-language/bus70-franchise-rule-compliance-guide.pdf>, at 6.

¹⁵ 16 C.F.R. §436.1(h) (2007).

¹⁶ *Id.* at §436.5.

¹⁷ FTC Compliance Guide at 24-123.

¹⁸ California Franchise Investment Law, CAL. CORP. CODE §§31000-158 (2023); Hawaii Franchise Investment Law, HAW. REV. STAT. §§482E-1 to -12 (2008); Illinois Franchise Disclosure Act of 1987, 815 ILL. COMP. STAT. 705/1 - /44 (2009); Indiana Franchise Act, IND. CODE §§23-2-2.5-1 to -51 (2016); Maryland Franchise Registration and Disclosure Law, MD. CODE ANN., Bus. Reg. §§14-201 to -233 (2010); Michigan Franchise Investment Law, MICH. COMP. LAWS §§445.1501 *et seq.* (2016); Minnesota Franchise Act, MINN. STAT. §§80C.01 - .22 (2023); New York Franchise Act, N.Y. GEN. BUS. LAW §§680-685 (2011); North Dakota Franchise Investment Law, N.D. CENT. CODE §§51-19-01 to -17 (2001); Rhode Island Franchise Investment Act, R.I. GEN. LAWS §§19-28.1-1 to -34 (2016); South Dakota Franchise Investment Law, S.D. CODIFIED LAWS §§37-5B-1 to -53 (2017); Virginia Retail Franchising Act, VA. CODE ANN. §§13.1-557 to -574 (2009); Washington Franchise Investment Protection Act, WASH. REV. CODE §§19.100.010 - .940 (2012); Wisconsin Franchise Investment Law, WIS. STAT. §§553.01 *et seq.* (2008).

Administrators Association’s 2008 Franchise Registration and Disclosure Guidelines (“NASAA Guidelines”) before filing their disclosure documents with the Registration States.¹⁹

Although no federal law or statute specifically regulates a franchisor’s ability to establish and manage a Marketing Fund in their franchise systems, the FTC Franchise Rule requires disclosures about the franchisor’s marketing program, including Marketing Funds and local marketing requirements, throughout various items of the FDD as described in more detail in the paragraphs below.

A. The FTC Franchise Rule

1. Item 1: The Franchisor, and any Parents, Predecessors and Affiliates

In Item 1, franchisors must disclose the name and principal business address of the franchisor, any parent companies, and any affiliates that offer franchises in any line of business and/or provide products or services to the franchisees.²⁰ An “affiliate” is defined as “an entity controlled by, controlling, or under common control with another entity.”²¹ As a result, a franchisor may need to make disclosures in Item 1 about the Marketing Fund or other marketing issues depending upon its corporate structure and the nature of the franchise system’s industry.

For example, a franchisor may elect to establish a separate legal entity to manage its Marketing Fund. In that case, the Marketing Fund entity typically has its own officers and is run as a separate business channel with independent financial statements, which should make it easier to demonstrate that there has been no comingling of operating funds with franchisee Marketing Fund contributions. Creating a separate legal entity can be advantageous in that the directors of the entity have certain fiduciary and other duties under the state law of the entity’s formation and the assets of the entity cannot be reached by any creditors of the franchisor or its franchisees. If properly set up and administered, the franchisor will not have liability for the actions of the Marketing Fund entity. The governing documents of the entity will address issues related to the collection and expenditure of Marketing Fund contributions. The franchisor will cede control of the administration of the Marketing Fund to the new entity, which will administer the fund and make decisions regarding marketing campaigns (although the franchisor typically provides some input). The Marketing Fund entity generally provides financial reports to the franchise system and is typically operated as a not-for-profit entity. Franchisees pay their Marketing Fund contributions directly to the Marketing Fund entity, or in some cases, the franchisor receives the contributions and transfers them to the Marketing Fund entity. In this scenario, the franchisor must disclose the Marketing Fund affiliate in Item 1 of the FDD because the affiliate provides services to the franchisees. In addition to the name

¹⁹ North American Securities Administrators Association, *2008 Franchise Registration and Disclosure Guidelines*, Bus. Franchise Guide (CCH) ¶ 5,705, at 1 (2008); available at <https://www.nasaa.org/industry-resources/uniform-forms/franchise-registration-and-disclosure-guidelines/>.

²⁰ 16 C.F.R. §436.5(a)(1).

²¹ *Id.* at §436.1(b).

and principal business address of the affiliate, franchisors must disclose whether the affiliate has operated any of the franchised businesses and whether the affiliate has offered franchises in another line of business.²²

Franchisors also must disclose industry-specific regulations in Item 1,²³ including any industry-specific advertising laws or regulations (or self-regulations) that apply to the franchise concept, such as those regulating hotel fees, car rentals, drug products, or alcohol sales.²⁴

2. Item 2: Business Experience

Item 2 requires franchisors to disclose their principal directors, officers and any other people who manage the sale or operation of the franchise system. Required disclosures include the name, principal positions and employers for the previous five years including the start and end date of each position and the location.²⁵ Most franchisors will disclose biographical information of their team members who manage the Marketing Fund and the system's marketing efforts.

3. Item 3: Litigation

Franchisors must disclose certain litigation matters of the franchisor, a predecessor, a parent or affiliate who induces franchise sales by backing the franchisor financially or guarantees the franchisor's performance, and any individual included in Item 2.²⁶ For pending matters, disclosure is required of administrative, criminal or material civil actions²⁷ alleging a violation of a franchise, antitrust, or securities law, or alleging fraud, unfair or deceptive practices or comparable allegations²⁸ and civil actions, other than routine litigation incidental to the business, which are material with respect to the number of franchises in the system, the size of the franchise system, and the financial condition of the franchise system and its business operations.²⁹ For concluded matters, disclosure is required of any actions in the prior ten-year period where individuals or entities were convicted or pleaded nolo contendere to a felony charge or were held liable in a civil action that alleged a violation of franchise, antitrust or securities laws, or involved allegations of fraud, unfair or deceptive practices or comparable allegations.³⁰ "Held liable" means that the person was required to pay money or other consideration, reduce an indebtedness by the amount awarded, cannot enforce its rights, or must take actions adverse to its interests.³¹ Additionally, disclosure is required of certain government actions including injunctive or restrictive orders resulting from any government action

²² *Id.* at §436.5(a)(7).

²³ *Id.* at §436.5(a)(6)(v).

²⁴ *See, infra*, note 131 and accompanying text for additional information on industry-specific advertising regulations.

²⁵ 16 C.F.R. §436.5(b).

²⁶ *Id.* at §436.5(c).

²⁷ A "material civil action" for purposes of Item 3 is "one that is likely to influence a prospective franchisee's investment decision." FTC Compliance Guide at 35.

²⁸ 16 C.F.R. §436.5(c)(1)(i)(A).

²⁹ *Id.* at §436.5(c)(1)(i)(B).

³⁰ *Id.* at §436.5(c)(1)(iii).

³¹ *Id.*

related to the franchise or a federal, state, or Canadian franchise, securities, antitrust, trade regulation or trade practice law.³²

Legal actions brought by franchisees related to the administration and/or misuse of Marketing Fund contributions may qualify as “material civil actions ... alleging fraud, unfair, or deceptive practices,” and if so, must be disclosed. Franchisors should carefully analyze any actions filed during a year, including with respect to the Marketing Fund, to determine whether the FDD must be amended to disclose the new litigation.

4. Item 5: Initial Fees

Item 5 requires the disclosure of any payments that a franchisee must make to the franchisor or its affiliate before the franchised business opens. The term “initial fees” is not limited to an initial franchise fee or development fee and instead includes all fees or payments for goods and services received from the franchisor or any affiliate before the business opens, whether in a lump sum or installments.³³ Franchisors that require franchisees to make a pre-opening grand opening marketing payment to the franchisor or a contribution to the Marketing Fund or an advertising cooperative would therefore need to disclose these requirements in Item 5.

5. Item 6: Other Fees

In item 6, franchisors must disclose the fees that a franchisee is required to pay to the franchisor or its affiliates after the outlet opens, including fees that the franchisor collects and pays to a third party.³⁴ All Marketing Fund and advertising cooperative contributions fall within this category, and therefore, must be disclosed in Item 6. The disclosures should track the language in the franchise agreement and disclose whether the contribution rates will vary over time or based on different revenue thresholds. In that event, the disclosures should address the formula for determining the variation and the maximum amount the contributions may increase. If the franchisor has advertising cooperatives, the notes must describe the voting power of franchisor-owned outlets on any fees imposed by the cooperatives. If the franchisor-owned outlets have controlling voting power, then disclosures must include the maximum and minimum fees that may be imposed.³⁵

6. Item 7: Estimated Initial Investment

Item 7 includes the estimated initial investment that a franchisee must make to open their franchised outlet.³⁶ When making disclosures related to a franchise system’s estimated initial investment, franchisors should disclose any pre-opening grand opening marketing payment to the franchisor or a contribution to the Marketing Fund or an advertising cooperative. Additionally, franchisors must disclose other required

³² *Id.* at §436.5(c)(2).

³³ *Id.* at §436.5(d).

³⁴ *Id.* at §436.5(f).

³⁵ *Id.*

³⁶ *Id.* at §436.5(g).

expenditures the franchisee will incur during the initial period of operation,³⁷ including advertising expenditures. Notably, the FTC Compliance Guide specifically includes a row disclosing the advertising fees charged during the initial three months of operation.³⁸

7. Item 8: Restrictions on Sources of Products and Services

Item 8 includes disclosures related to franchisee requirements to purchase or lease goods, services, supplies, fixtures, equipment, inventory, computer hardware and software, real estate or comparable items from approved suppliers or in accordance with the franchisor's specifications. For each obligation, the franchisor should disclose the good or service required to be purchased or leased and whether the franchisor or its affiliates are approved suppliers or the only approved suppliers of that good or service. Franchisors also must disclose whether they or their affiliates will derive revenue from these required purchases or leases. For example, if the franchisor requires its franchisees to purchase advertising materials from an approved supplier or requires use of a particular advertising agency, then this must be disclosed in Item 8. If the franchisor receives rebates or other benefits from those required purchases, or if the franchisor or an affiliate supplies the required advertising materials or services, the franchisor must disclose: (1) the revenues derived in the preceding fiscal year from the rebates or purchases; and (2) the percentage of the franchisor's total revenues represented by the rebates or purchases.³⁹

8. Item 9: Franchisee's Obligations

Item 9 includes a summary in a tabular format of the franchisee's obligations under the franchise agreement and other agreements with a reference to the particular agreement's section and FDD disclosure item. Item 9(o) requires references to the franchisee's advertising obligations.⁴⁰ In addition to advertising obligations that are contained within their franchise agreements, franchisors should disclose references to any ancillary advertising agreements such as advertising cooperative agreements.

9. Item 11: Franchisor's Assistance, Advertising, Computer Systems and Training

Item 11 of the FDD contains the bulk of the required advertising disclosures. Here, franchisors must include detailed descriptions of the franchisor's and franchisees' obligations to conduct marketing, along with specific references to each section of the franchise agreement establishing the obligation. Item 11 divides these obligations into five general categories.

³⁷ *Id.* at §436.5(g)(1)(iii) (stating that "a reasonable initial period is at least three months or a reasonable period for the industry.")

³⁸ FTC Compliance Guide at 50.

³⁹ 16 C.F.R §436.5(h).

⁴⁰ *Id.* at §436.5(i).

a) The Franchisor's Obligation to Conduct Advertising

Franchisors must disclose any obligations they have to conduct advertising for the franchise system, including the media they may use (e.g. print, radio, television, internet, social media, digital), the geographic scope of the advertising, including whether the media coverage is local, regional or national; the source of the advertising (whether in-house or an external agency); and whether the franchisor must spend any amount on advertising in the area or territory where the franchisee is located.⁴¹ This disclosure provides prospective franchisees with insight into the breadth of the franchisor's advertising programs.

b) The Franchisee's Use of Its Own Advertising Materials

Franchisors also must disclose the circumstances when franchisees may use their own advertising materials.⁴² To meet this requirement, most franchisors will include a description of their franchisee's obligations to conduct local advertising on a continuing basis, along with disclosures regarding the process for franchisees to obtain the franchisor's approval of advertising materials created by the franchisee. These provisions also typically require franchisees to comply with all applicable laws when conducting local advertising and refer to any permitted use of social media platforms.

c) Advertising Councils

Another mandatory disclosure is whether the franchise system has an advertising council composed of franchisees to advise the franchisor on advertising policies. If so, the franchisor must disclose how members of the council are selected; whether the council serves in an advisory capacity only or has operational or decision-making power; and whether the franchisor has the power to form, change, or dissolve the advertising council.⁴³ This provides the franchisees with insight as to the influence they may have over systemwide advertising.

d) Advertising Cooperatives

Franchisors also must disclose whether their franchisees must participate in a local or regional advertising cooperative. If so, the franchisor must state: how the area or membership of the cooperative is defined; how much the franchisee must contribute to the cooperative and whether other franchisees contribute a different amount or rate; whether the franchisor-owned outlets contribute to the cooperative and, if so, whether those contributions are on the same basis as those for franchisees; who is responsible for administering the cooperative (e.g. the franchisor, franchisees, or an advertising agency); whether the cooperative will operate from written governing documents and whether the documents are available for the franchisee to review; whether the cooperative must prepare annual or periodic financial statements and whether the

⁴¹ *Id.* at §436.5(k)(4).

⁴² *Id.* at §436.5(k)(ii); *see infra* Section IV for a more detailed discussion of local marketing.

⁴³ *Id.* at §436.5(k)(iii); *see infra* Section III.D. for a more detailed discussion of advertising advisory councils.

statements are available for review by the franchisee; and whether the franchisor has the power to require cooperatives to be formed, changed, dissolved, or merged.⁴⁴

e) Marketing Funds

With regard to their Marketing Funds (national or regional), franchisors must disclose: who contributes to the fund; the amount of the franchisee's contribution and whether other franchisees must contribute a different amount or at a different rate; whether franchisor-owned outlets must contribute to the fund and, if so, whether those contributions are on the same basis as franchisees do; who administers the fund; whether and when the fund is audited; if financial statements of the fund are available for review by the franchisee; how the contributions were used in the most recently concluded fiscal year, including the percentages spent on production, media placement, administrative expenses, and a description of any other use; how the franchisor uses any funds not spent in a fiscal year in which they accrue; whether the franchisees receive a periodic accounting of how the contributions were spent; and the percentage of advertising funds, if any, the franchisor uses principally to solicit new franchise sales.⁴⁵

With respect to the disclosures regarding the allocation of production and administrative expenses, the FTC Compliance Guide indicates that a franchisor's internal costs related to production (such as supplies, photography and graphics) can be included in production expenses if the franchisor has "a reasonable basis for claiming the allocation of production expenses at the time disclosure is made."⁴⁶ Additionally, reasonable salaries of franchisor personnel paid by the Marketing Fund can be included in production or administrative expenses if the franchisor describes the allocation.⁴⁷

Additionally, the FTC Compliance Guide indicates that franchisors who have multi-brand offerings should segregate the disclosures for each brand. However, if it is unreasonable to segregate its Marketing Fund disclosures across brands, the franchisor may aggregate such disclosures if they clearly disclose this fact.⁴⁸

10. Item 12: Territory

In Item 12, franchisors are required to include disclosures regarding assigned territories and applicable sales restrictions. Additionally, franchisors must disclose: (1) whether the franchisor can advertise and accept orders from consumers in the franchisee's territory; (2) whether the franchisor reserves any right to use alternative channels of distribution within a franchisee's territory including sales over the Internet, catalog sales, direct marketing, and telemarketing sales; and (3) any compensation that will be paid by the franchisor for soliciting or accepting orders in a franchisee's territory. Likewise, the franchisor must disclose similar information regarding whether a franchisee can solicit or accept orders from outside its territory including any right to distribute

⁴⁴ *Id.* at §436.5(k)(iv); *see infra* Section IV. D. for a more detailed discussion of advertising cooperatives.

⁴⁵ *Id.* at §436.5(k)(iv).

⁴⁶ FTC Compliance Guide at 66; *see infra* Section III.C. for an additional discussion of multi-brand issues.

⁴⁷ *Id.*; *see infra* Section III.A.iii. for a more detailed discussion of Marketing Fund allocations to administrative expenses.

⁴⁸ *Id.*

through alternative channels such as the Internet, catalog sales, telemarketing and other direct marketing.⁴⁹

11. Item 22: Contracts

Item 22 requires franchisors to include as exhibits to the FDD all contracts a franchisee must sign related to the franchise offering.⁵⁰ If a franchisor requires a franchisee to sign any advertising agreements, including advertising cooperative agreements, then those agreements should be identified in Item 22 and attached as exhibits to the FDD.

B. State Law and Regulations

Although several states have statutes that indirectly regulate Marketing Funds through good faith requirements⁵¹ and through prohibition of deceptive or unfair practices,⁵² only a handful of state franchise laws and regulations include requirements that relate specifically to advertising fees charged by franchisors.

Arkansas. Section 4-72-206(7) of the Arkansas Franchise Practices Act (“AFPA”) prohibits franchisors from collecting a percentage of a franchisee’s sales as an advertising fee and not using these amounts to advertise the franchisee’s business.⁵³ It is not clear from the wording of the statute how to interpret the term “franchisee’s business” and whether a franchisor can comply with Section 4-72-206 by using advertising fees to market businesses in the franchise system as a whole or whether the franchisor must use the fees only to market the franchisee’s specific business in Arkansas. In 1991, the Arkansas General Assembly further confused matters by amending the AFPA and adding Section 4-72-203, which states that the AFPA does not apply to franchises that are subject to the FTC Franchise Rule.⁵⁴ In *Lodging Development & Management Inc. v. Days Inns Worldwide, Inc.*, the court acknowledged the confusion created by Section 4-72-203 and opined that perhaps the legislature intended only to refer to the pre-sale disclosure requirements of the FTC Franchise Rule rather than the entire AFPA because if all franchises were exempted from the AFPA, then nothing would be left of the AFPA.⁵⁵ However, in *J.K.P. Foods, Inc. v. McDonald’s Corporation*, the court granted McDonald’s Corporation’s motion to dismiss claims under the AFPA arising out of its rejection of a franchisee’s transfer request since McDonald’s Corporation was subject to the FTC Franchise Rule.⁵⁶

⁴⁹ 16 C.F.R. §436.5(l).

⁵⁰ *Id.* at §436.5(v).

⁵¹ *See, e.g.* IOWA CODE §523H.10 and Wash. Rev. Code §19.100.180.

⁵² *See, e.g.* FLA. STAT. §501.204 and TEX. BUS. & COM. CODE ANN. §17.46. Little FTC Acts in many states similarly prohibit unfair and deceptive conduct in advertising. *See, e.g.* MD. CODE ANN. §13-105; R.I. GEN. LAWS §6-13.1-3; and WASH. REV. CODE §19.86.920.

⁵³ ARK. CODE ANN. §4-72-206(7).

⁵⁴ *Id.* at §4-72-203.

⁵⁵ *Lodging Development & Management Inc. v. Days Inns Worldwide, Inc.*, 2001 WL 35756572 at *3 (E.D. Ark. 2001).

⁵⁶ *J.K.P. Foods, Inc. v. McDonald’s Corporation*, 420 F.Supp.2d 966, 973 (E.D. Ark. 2006).

Hawaii. The Hawaii Franchise Investment Law (“HFIL”) requires franchisors and franchisees to deal with each other in good faith⁵⁷ and prohibits franchisors from discriminating between franchisees in the charges for advertising services or other fees unless the classification of the franchisee or the discrimination between franchisees is based on franchises granted at materially different times, is related to incentive programs for franchisees lacking capital or experience, is related to local experimentation with variations in product or service lines or business formats and designs, is related to efforts by franchisees to cure defaults, or is based on other reasonable distinctions that are not arbitrary.⁵⁸

Illinois. The Illinois Franchise Disclosure Act (“IFDA”) prohibits franchisors from discriminating between franchisees in the charges for advertising services and other fees “if such discrimination would cause competitive harm to a franchisee who competes with a franchisee that received the benefit of the discrimination.”⁵⁹ However, like the HFIL, the IFDA allows the classification of franchisees or discrimination in certain situations.

Indiana. The Indiana Deceptive Franchise Practices Act (“IDFPA”) prohibits franchise agreements from containing any provisions that requires a franchisee to participate in any “(A) advertising campaign or contest; (B) promotional campaign; (C) promotional materials; or (D) display decorations or materials; at an expense to the franchisee that is indeterminate, determined by a third party, or determined by a formula, unless the franchise agreement specifies the maximum percentage of gross monthly sales or the maximum absolute sum that the franchisee may be required to pay.”⁶⁰ Most franchise agreements specify the amount a franchisee must contribute to a Marketing Fund making this provision of the IDFPA largely inapplicable.

Minnesota. The Minnesota Department of Commerce has issued a regulation prohibiting discrimination in the charges for advertising services and other fees unless “any classification of or discrimination between franchisees is based on franchises granted at different times, geographic, market, volume or size differences, costs incurred by the franchisor, or other reasonable grounds....”⁶¹

Washington. The Washington Franchise Investment Protection Act also prohibits franchisors from discriminating between franchisees in charges for advertising services and other fees unless the franchisor proves the classification of franchisees or discrimination is reasonable, based on franchises granted at different times and such discrimination is related to the difference in time or is based on other proper distinctions and is not arbitrary.⁶²

⁵⁷ HAW. REV. STAT. §482E-6(1).

⁵⁸ *Id.* at §482E-(6)(2)(C).

⁵⁹ 815 ILL. COMP. STAT. 705/18.

⁶⁰ IND. CODE ANN. §23-2-2.7-1(11).

⁶¹ MINN. R. 2860.4400.

⁶² WASH. REV. CODE §19.100.180(2)(c).

With this legal framework in mind, Sections III and IV turn to a more detailed discussion of how franchisors administer their Marketing Funds and the local marketing requirements they typically impose on their franchisees.

III. FRANCHISOR ADMINISTRATION OF MARKETING FUNDS

Franchisors often cite the promotion of “brand awareness” or “visibility” as fundamental goals of Marketing Funds,⁶³ but the reality is that the permitted uses of Marketing Fund contributions are oftentimes materially broader than franchisees (and, perhaps, even franchisors) might expect. As a result, Marketing Fund spending issues are a frequent source of tension in franchise systems. Issues concerning contributions to Marketing Funds (*e.g.*, who contributes to the fund, whether there are variations in contribution levels, and whether contributions can change over the term of a franchise agreement) also are somewhat common in franchise systems. On top of all of this, another issue that frequently arises with Marketing Funds involves who has a say in key Marketing Fund decisions.

With all of these issues and potential conflict points in mind, this Section of the paper will discuss permitted uses of the Marketing Fund dollars, contribution issues within Marketing Funds, Marketing Fund usage in multi-brand systems, franchisee marketing advisory councils, and brand promotions that impact franchisees.

A. Permitted Uses under the Franchise Agreement

Contributions to a Marketing Fund generally represent a significant cost to franchisees and a significant source of funding for a franchisor. Because of this, the permitted uses of Marketing Fund dollars are of particular interest and importance to both franchisees and franchisors.

Generally, franchisors cannot use Marketing Fund contributions for any purpose they wish without any limits. Instead, certain specific provisions in the franchise agreement (as described in Item 11 of the FDD) will typically set forth the permitted (and sometimes non-permitted) uses of Marketing Fund dollars. That said, some franchise agreements and FDDs give franchisors virtually unlimited latitude on how the funds are spent as long as there is some connection to marketing, public relations, brand image, and the like. Even franchise agreements that contain some limitations are still generally quite broad – although some do impose obligations of “good faith” and other express limitations.⁶⁴ In addition to permitted activities for Marketing Fund expenditures, the franchise agreement and the FDD may discuss the use of the fund for fees and expenses the franchisor may incur in connection with the administration of the Marketing Fund and any limits on such administration fees and expenses.

⁶³ See Taco Bell Franchisor, LLC Franchise Disclosure Document (March 27, 2023, as amended September 18, 2023), available at https://www.cards.commerce.state.mn.us/documents/%7B10A8D18A-0000-C816-86E0-6B4AE0253E7E%7D/download?documentClass=FRANCHISE_REGISTRATIONS&contentSequence=0 (last visited March 28, 2024) (“Taco Bell FDD”), at 43.

⁶⁴ See Taco Bell FDD at 43 for an example of such a limitation.

1. How are Franchisors Using Marketing Funds?

A wide range of activities may be considered appropriate uses of the Marketing Fund under the applicable franchise documents. Franchisees (and some franchisor executives) may believe that Marketing Funds should be used primarily for media placement. That may often be the case (indeed, media placement frequently, but not always, makes up the highest percentage of Marketing Fund expenditures),⁶⁵ but the permitted uses of Marketing Fund dollars and the manner in which the uses are described in the franchise agreement and FDD can vary considerably among different franchise systems.

Some franchise agreements and FDDs establish specific criteria identifying the types of activities and purposes for which Marketing Fund dollars may be used and give the franchisor significant latitude to spend Marketing Fund dollars in their sole discretion. An example of a broad disclosure on Marketing Fund usage follows:

The Brand Building Fund, and all contributions to and earnings from the Brand Building Fund, will be used exclusively to meet the costs of marketing and any other activities that we believe will enhance the System's image and, in our sole discretion, promote general public awareness of and favorable support for the System. This includes, among other things:

- i. the costs of preparing and conducting media advertising campaigns (including tests);
- ii. use of new and emerging media including internet vehicles; direct mail advertising;
- iii. marketing surveys, consumer research, customer relationship management, and other public relations activities;
- iv. developing and maintaining our primary website and other associated brand sites, including mobile applications;
- v. developing and maintaining support of off-premises channels (e.g. Denny's on Demand) and other guest experience-driven initiatives (e.g. table top tablets, curbside);
- vi. employing advertising, multicultural, research or public relations agencies;
- vii. costs of tools and consultants supporting data and pricing expertise;
- viii. partnerships and promotional spend with entities benefiting national footprint;
- ix. costs of the Denny's personnel who handle the brand marketing;
- x. costs of promotional and obsolete inventory not purchased by any restaurant;

⁶⁵ See Qdoba FDD at 29; Culver FDD at 18; Domino's Pizza Franchising, LLC Franchise Disclosure Document (April 1, 2023, as amended August 2, 2023), available at https://www.cards.commerce.state.mn.us/documents/%7B002DFA89-0000-CE5F-9A12-C784DC31254A%7D/download?documentClass=FRANCHISE_REGISTRATIONS&contentSequence=0 (last visited March 28, 2024) ("Domino's FDD"), at 35.

- xi. purchasing promotional items, conducting and administering visual merchandising, point of sale, and other merchandising programs;
- xii. public outreach and brand promotion, such as the Denny's Mobile Relief Diner; and
- xiii. providing promotional and other marketing materials and services to Denny's Restaurants.⁶⁶

As a general matter, this disclosure details a rather broad reservation of the franchisor's rights because it begins by stating that the franchisor has "sole discretion" regarding use of the funds and then identifies certain permissible broad stroke concepts (improving the image, awareness, and support of the system). Equally important, the disclosure continues by noting that the broad reservation of rights includes "among other things," certain specific and identified purposes.

Not all disclosures of the franchisor's reserved rights take this form. For example, the following appeared in another recent FDD:

The Company shall use the Marketing Fund in its good faith determination to disseminate, improve and support the public awareness and image of the Taco Bell brand, the Taco Bell System and its goods and services available to the public, to increase System-wide sales, to purchase advertising, to pay for the development, support, and dissemination of other marketing and media programs on a regional or national basis (including but not limited to promotions, public relations, event marketing, research and clearance of programs, talent and residuals), to pay for the creation and production of advertising, and as otherwise permitted by the Marketing Fund Policy; provided, however, in any given calendar year not more than one-quarter of the aggregate of all marketing fees contributed to the Marketing Fund from franchise and Company Restaurants in the United States (except Hawaii) shall be spent on the production and creation of advertising.⁶⁷

In this disclosure, the franchisor agrees to act in "good faith" when determining how to use the funds, but does not specify detailed uses for the Marketing Fund in the FDD. Instead, it refers to more general uses of the Marketing Fund (e.g., development, support, and dissemination of other marketing and media programs), and then refers to a "Marketing Fund Policy," which, presumably, contains more specific rights and limitations.

Overall, based on the authors' FDD research for this paper, there appears to be a general trend of allowing for a far broader use by franchisors of Marketing Fund dollars

⁶⁶ See DFO, LLC Franchise Disclosure Document (April 30, 2023), available at https://www.cards.commerce.state.mn.us/documents/%7B50AFB689-0000-CA51-A1AF-B0E6D7C2E69F%7D/download?documentClass=FRANCHISE_REGISTRATIONS&contentSequence=0 (last visited March 28, 2024) ("Denny's FDD"), at 48. In this paper, we include disclosures from FDDs that summarize the franchisor's rights and obligation under the franchise agreements related to the Marketing Fund. The reserved rights in some franchisors' actual franchise agreements may be more detailed and/or broader than the summaries found in their FDDs.

⁶⁷ See Taco Bell FDD at Franchise Agreement §6.1(c).

than many franchisee might expect. Indeed, absent an express provision in the franchise agreement and FDD that Marketing Funds could be used to “purchase obsolete inventory,” not many franchisees would likely expect that a Marketing Fund would be used for that purpose.⁶⁸

In sum, if a franchisor knows that it wishes to spend Marketing Fund dollars for non-traditional expenditures beyond media placement and production, a best practice would likely be to expressly mention that purpose in the FDD disclosure and terms of the franchise agreement (instead of relying upon a more general reservation of rights) while being clear that the list of purposes is not an exhaustive list. At the same time, franchisors should keep in mind that even if they change the language in a new franchise agreement to expand the purposes for which Marketing Fund contributions may be used, old franchise agreements (with more limited language) will continue to be in place for some time. As a result, an expansion of the permissible uses of a Marketing Fund may take some time to implement (as a newly desired use may not be permissible under older forms of the franchise agreement and FDD).

2. Administrative Fees and Expenses

FDD disclosures and franchise agreement provisions also note whether Marketing Funds may be used to cover the franchisor’s administrative costs. These costs can include costs ranging from marketing employee salaries to travel, conference expenses, and other expenditures related to the administration of marketing activities.⁶⁹

Franchisees are often understandably concerned about Marketing Fund spending relating to administrative costs, as the typically broad discretion given to franchisors may appear to allow franchisors to use the Marketing Fund to cover costs the franchisor would incur even if there was no Marketing Fund (e.g., overhead expenses and expenses related to non-marketing employees). As a result, franchisees who review their franchise systems’ FDDs regularly may be concerned by disclosed administrative fees and costs that seem overly high.

With that in mind, the authors found the significant variation in the disclosures related to administrative expenses disclosed in FDDs reviewed for this paper to be interesting. For example, in the FDDs reviewed, the administrative fees disclosed in Item 11 ranged from 0.5% of the annual Marketing Fund⁷⁰ spending at the lowest to 18% of the fund⁷¹ at the highest.⁷² That said, as is generally the case, a disclosure in a vacuum may not tell the whole story. A prospective franchisee reviewing an FDD should take a deeper look into the disclosure and ask the franchisor to better understand what is

⁶⁸ See Denny’s FDD at 48.

⁶⁹ For an example of language regarding administrative costs, See Qdoba FDD at 23.

⁷⁰ See Taco Bell FDD at 43.

⁷¹ See Snap Fitness, Inc. Franchise Disclosure Document (May 18, 2023), available at https://www.cards.commerce.state.mn.us/documents/%7B707D1C89-0000-CFA1-9E9F-778674814529%7D/download?documentClass=FRANCHISE_REGISTRATIONS&contentSequence=0_0 (last visited March 28, 2024) (“Snap Fitness FDD”), at 22.

⁷² This is based on a review of a sample of dozens of FDDs for franchisors in a variety of industries, with systems of varying sizes and years of experience in franchising.

happening, e.g., is the administrative expense high because there is a large in-house marketing team? But, even if explainable, franchisors should be aware that disclosure of a high percentage of Marketing Fund expenditures allocated to administrative expenses may be a red flag (or at least a cause for concern) to a prospective franchisee. In addition, allocation of Marketing Fund dollars to franchisor employee salaries and other administrative fees could lead to litigation by existing franchisees.⁷³

B. Marketing Fund Contribution Issues

While the question of how Marketing Funds are spent is very important to franchisees and franchisors alike, an equally important set of questions focuses on how much a franchisee must contribute. The following paragraphs discuss some of the most common contribution issues, including whether company-owned units contribute to the Marketing Fund, how variations in contribution rate among franchisees are handled (if at all), and whether there is a right to increase the Marketing Fund contribution rate during the term of the franchise agreement.

1. Company-Owned Unit Contributions

Are franchisees the only ones with financial “skin in the game” regarding Marketing Fund contributions? Or do company-owned units (*i.e.*, units owned by the franchisor or its affiliates) contribute as well, and, if so, in what amount? The answer to those questions will depend upon the particular franchised system, but, based on our research for this paper, it appears to be a very rare occurrence that company-owned units do not contribute to the Marketing Fund at all. Instead, the issue is more about the level of the contributions and how they are handled.⁷⁴

Some franchisors choose to have their company-owned units contribute at the same rate as similarly situated franchisees. An example of a provision adopting this approach reads:

All franchisees operating The UPS Store Centers contribute to the NAF at the same rate. Any and all The UPS Store Centers that we currently own, or may own in the future, must contribute to the NAF on the same basis.⁷⁵

For franchisors with differing levels of contributions among their franchisees, the provision will likely be something like the following; “All company or affiliate-owned Clubs

⁷³ See *Great White N. Franchisee Ass'n-USA, Inc. v. Tim Hortons USA, Inc.*, 2020 WL 8024349 (S.D. Fla. 2020); see, *infra*, note 105 and accompanying text.

⁷⁴ See, *supra*, Section II.A.9(e). The franchise laws do not generally require company-operated outlets to contribute at the same or similar rates as franchisees, but to comply with disclosure obligations under Item 11 of the FDD, franchisors do need to: (a) disclose what their policy is with respect to this issue; and (b) on an ongoing basis, ensure that they are complying with that policy.

⁷⁵ See The UPS Store, Inc. Franchise Disclosure Document (April 27, 2023, as amended December 5, 2023), available at https://www.cards.commerce.state.mn.us/documents/%7B50A48C8C-0000-CA12-BF0F-B1A6F9B443DF%7D/download?documentClass=FRANCHISE_REGISTRATIONS&contentSequence=0 (last visited March 28, 2024), at 61.

will contribute to the Marketing Fund on the same basis as similarly situated franchisees.”⁷⁶

2. Contribution Variations Among Franchisees

Franchise Agreements and FDDs typically describe the specific contributions franchisees must make to the Marketing Fund. While contribution forms may vary from system to system (e.g., percentage of gross sales, flat fees, etc.), most contributions are measured as a percentage of gross sales. A relatively standard provision describing contribution amounts may look like this:

If you operate a traditional Qdoba restaurant, you will be required to make weekly advertising contributions to the Marketing Fund in an amount of two and one-quarter percent (2.25%) of the Gross Sales (as defined in the Franchise Agreement) from your restaurant.⁷⁷

The frequency at which franchisees are required to contribute to the Marketing Fund may vary by system. Some systems require weekly contributions,⁷⁸ while others may choose to have franchisees contribute every month.⁷⁹ Contribution frequency is typically denoted in either Item 6 or Item 11 of the FDD, but, in general, matches the frequency with which royalties are paid.

While contribution amounts are typically fixed within the Franchise Agreement and other relevant agreements, there are a variety of situations in which franchisees may find themselves contributing at different rates.

One potential reason for contribution differences is franchisor discretion. Some franchisors explicitly reserve the ability to reduce the Marketing Fund contribution rate for franchisees performing either extremely well or extremely poorly in relation to the brand as a whole, to encourage growth, or due to an otherwise unique set of circumstances. An example of an FDD provision granting franchisors this ability reads as follows:

We may from time to time implement incentive programs to encourage system growth, improve store performance or accomplish other objectives designed to benefit the System. Under these incentive programs, we may reduce weekly royalty fees and/or reduce or eliminate advertising contributions payable by a participating franchisee for a period of time, including national and mandatory local advertising contributions...⁸⁰

⁷⁶ See Snap Fitness FDD at 23.

⁷⁷ See Qdoba FDD at 28.

⁷⁸ See Popeye’s Louisiana Kitchen Inc. Franchise Disclosure Document, (March 24, 2023), available at https://www.cards.commerce.state.mn.us/documents/%7B90696B87-0000-C52D-AAF6-536106D3889D%7D/download?documentClass=FRANCHISE_REGISTRATIONS&contentSequence=0 (last visited March 28, 2024), at 18.

⁷⁹ See Culver FDD at 7.

⁸⁰ See Domino’s FDD at 18.

Franchisors with this ability may leverage lower Marketing Fund contribution rates to incentivize things such as store remodeling, adoption of promotional programs, or other goals as the franchisor sees fit.

Another reason franchisees may contribute at different rates to a Marketing Fund is the different dates of execution for franchise agreements and other relevant documents. While the FDD provides a “snapshot” of the current Marketing Fund contributions, the franchise agreement is the document that governs the rate at which franchisees contribute. As such, those franchisees who have signed their franchise agreements prior to franchisor-initiated contribution rate increases may be “grandfathered in” for the duration of their agreements (or longer, depending on future negotiations). When a franchisor sets a new rate under a new franchise agreement released by the franchisor for future franchisees, the franchisor does not automatically have the right to change the rate for existing franchisees operating under earlier franchise agreement forms unless the franchisor has explicitly reserved that right.

Franchisors also typically reduce the contribution rates for non-traditional locations focused on captive audience customers. In non-traditional locations with a captive audience (e.g., special events centers, parks, stadiums, arenas, business and industrial complexes, museums, military bases, airports, public transportation facilities, health care facilities, highway rest stops, colleges, universities, warehouse clubs, theme parks, amusement centers, truck stops, and casinos), the customer base is built in because the customers are generally visiting the main location, and the customers have nowhere else to go to purchase what they want or need. For instance, a family visiting a stadium for a baseball game that wants lunch will usually opt to eat at the stadium instead of waiting until after the game and going somewhere else to eat. Since franchisees focusing on a captive audience may have limited or no ability to effectively advertise their businesses to customers who will patronize their locations, franchisors will usually reduce or eliminate their contribution rate.⁸¹

A final way franchise contribution rates may differ is through negotiated changes. In some instances, franchisees may negotiate a temporary reduction or elimination of contributions when their businesses struggle financially. Franchisees may also, when they are initially entering the system, negotiate for a “cap” on the contribution rate.

Franchisees are not the only ones who can initiate negotiated changes. In our research for this paper, we found numerous examples of franchisors initiating changes to the Marketing Fund contributions. An example of a franchisor doing this can be found below. This is language surrounding a “supplemental Marketing Fund” initiated by Massage Envy:

Effective January 1, 2022, we established a Supplemental Marketing Fund for the purposes of funding centralized marketing and advertising efforts. Franchisees with active franchise agreements on the establishment date of

⁸¹ See Chris Egan and Suzie Trigg, *Food Trucks, Kiosks and other Alternative Venues: Structuring and Drafting Issues*, ABA 37TH ANNUAL FORUM ON FRANCHISING W-17, 28 (2014).

the Supplemental Marketing Fund were given an option to participate in the Supplemental Marketing Fund.

Participation in the Supplemental Marketing Fund is mandatory. You must contribute 2% of your annual Gross Sales to the Supplemental Marketing Fund.⁸²

Existing franchisees in this system had the option of whether or not they would like to participate in a promotion, while franchisees signing after the implementation of this initiative are required to participate.

3. Adjusting Fees

While Item 6 of the FDD discloses the Marketing Fund contribution rate as of the date of the FDD, the reality is that the relevant language in the franchise agreement (and disclosed in Item 6) often gives the franchisor the ability to change the contribution amount within the term of the agreement either unilaterally or with franchisee consent (via a system-wide vote).⁸³

Some franchise agreements contain language that maintains franchisee contributions at a fixed rate and does not allow franchisors to unilaterally modify that rate during the agreement term.⁸⁴ Other agreements contain language allowing franchisors to raise contribution rates to a certain extent but require a vote if the franchisor seeks to exceed those set limitations. An example of a disclosure allowing for the percentage to change over time reads as follows:

We may increase the rate by a half percent (0.5%) of Gross Sales in any 12-month period, up to a maximum of four percent (4%). Increases above four percent (4%) require approval by majority vote of system restaurants.⁸⁵

As the previous examples have shown, franchisors take various approaches to how and when they can modify contribution issues. Given the variations from system to system, franchisees need to understand their franchise agreements and how they limit or enable franchisor modification of contributions. Prospective franchisees should also review these provisions before signing, as contribution amounts are typically significant, and the franchisor's ability to unilaterally modify them can significantly impact the amount they pay to the franchisor.

In addition to simply raising the required contributions to the Marketing Fund, a number of franchised systems give the franchisor the ability to allocate a specific percentage of gross sales toward marketing, but then give the franchisor the ability to

⁸² See ME SPE Franchising, LLC Franchise Disclosure Document (April 28, 2023), available at https://www.cards.commerce.state.mn.us/documents/%7B1069D988-0000-C61F-B34C-8D6E5B915432%7D/download?documentClass=FRANCHISE_REGISTRATIONS&contentSequence=0 (March 28, 2024), at 40.

⁸³ Qdoba FDD at 28.

⁸⁴ Culvers FDD, Franchise Agreement §8A, Page B-9.

⁸⁵ Qdoba FDD, Franchise Agreement §14.1.1, Page 20.

decide which portion should be sent to the Marketing Fund and which portion should be spent locally or in a cooperative. For example,

We have the right to increase or decrease your required advertising contributions or payments to the Fund, to a Cooperative, or for Local Advertising (the funds paid pursuant to any such increase in advertising contributions to the Fund shall be used by us for specified purposes). However, we will not increase the total amount of your required contributions or payments to more than 5% of Gross Sales.⁸⁶

C. Administration of Marketing Funds with Multi-Brand Issues

A somewhat unique (but growing) issue related to Marketing Funds is how franchisors administer Marketing Funds when they or their affiliates own more than one franchise system. Franchisors take different approaches as to how the system-specific Marketing Funds interact with each other and whether there is an “umbrella fund” for the franchisor to use for general brand promotion.

Some franchisors include specific limitations regarding the maintenance and administration of system Marketing Funds in multi-brand systems. This could take the form of a commitment to keep the funds in a distinct account dedicated solely to that system’s marketing (as opposed to a general account for the overall brand). For example:

Dine Brands will maintain an account designated as the “Applebee’s Advertising Fund Account” in the name of Dine Brands (or a subsidiary thereof) for fees payable by our or Applebee’s Restaurants LLC’s franchisees to fund the national marketing and advertising activities and local advertising cooperatives with respect to the Applebee’s brand.⁸⁷

Less commonly, franchisors include language to allow themselves to use a portion of the system-specific Marketing Fund to contribute to a fund that will promote more than just one brand. For example, Unleashed Brands owns a number of different brands, including Urban Air. A disclosure from the Urban Air FDD states:

We have the right to establish an advertising fund separate from the NAF, which we call the Unleashed Fund. You will not contribute directly to the Unleashed Fund. The Unleashed Fund is identical to the NAF except that the funds are spent marketing all of the brands under the Unleashed Services umbrella; these brands currently include Urban Air Adventure Park, Snapology, TLG, PMA, Class 101, and XPL, but may include other brands in the future (collectively, the “Unleashed Brands”). When the Unleashed Fund is established, the NAF may contribute up to 5% of its monthly balance to the Unleashed Fund. All of the Unleashed Brands are

⁸⁶ See Applebee’s Franchisor, LLC Franchise Disclosure Document (March 27, 2023), available at https://www.cards.commerce.state.mn.us/documents/%7B80177C87-0000-C01C-A119-0F2D4B1415D3%7D/download?documentClass=FRANCHISE_REGISTRATIONS&contentSequence=0 (last visited March 28, 2024) (“Applebee’s FDD”), at 29.

⁸⁷ Applebee’s FDD at 28.

expected to contribute to the Unleashed Fund, except the percentage contributed by each Unleashed Brand's fund may vary. Only the Unleashed Brands that contribute to the Unleashed Fund are included in the advertising conducted by the fund. The Unleashed Fund is not audited, and we are not required to provide you a report of Unleashed Fund. We will have the right to cause the Unleashed Fund to be incorporated or operated through a separate entity our affiliates own and manage if we deem it appropriate, and the successor entity will have all of the same rights and duties.⁸⁸

Franchisees who are part of a multi-brand system will certainly have questions about how "their" funds are being spent, how costs are allocated amongst the various brands, etc. As the number of multi-brand systems increases, we expect this is an area where disputes may begin to arise with more frequency as franchisees would likely have concerns about equality between the brands.

D. Franchisee Advertising Advisory Councils

1. Franchisee Input in Marketing Fund Spending

While most agreements give franchisors significant discretion in Marketing Fund spending, many franchisors have expressly agreed to seek the input of their franchisees regarding Marketing Fund expenditures.

A common way franchisors seek input is through an "advisory council." While the operation and influence of advisory councils will undoubtedly vary from system to system, advisory councils typically are given some ability to make suggestions or provide input on how Marketing Funds are spent. The FDD language on advisory councils may, in its simplest form, read something like this:

We have created a Marketing Advisory Council to enhance the working relationship with our franchisees. The Marketing Advisory Council is composed of select Qdoba Franchise Association Board members and two additional members selected by Qdoba. Qdoba reserves the right to change or dissolve the Marketing Advisory Council. The Marketing Advisory Council serves in advisory capacity with respect to marketing policies and advertising and promotional programs but does not have final decision-making authority. We have final say over the policies and programs to be implemented.⁸⁹

Every FDD reviewed for this paper, which discusses such an advisory council, expressly states that the advisory council has only "advisory" power. In other words, while

⁸⁸ See UATP Management, LLC Franchise Disclosure Document, (April 28, 2023), available at https://www.cards.commerce.state.mn.us/documents/%7BF0604B89-0000-C9AF-AAD1-C7593480C5CD%7D/download?documentClass=FRANCHISE_REGISTRATIONS&contentSequence=0 (last visited March 28, 2024), at 36.

⁸⁹ See Qdoba FDD at 29.

the council can make suggestions and provide input, the franchisor is not bound to accept the council's input.

The advisory councils are oftentimes a distinct group of franchisees who are either appointed by the franchisor or nominated by their fellow franchisees. Alternatively, another way the advisory council may be populated is through an independent franchisee association, *e.g.*, a franchisee association's marketing committee may take the place of an advisory council.⁹⁰

2. Franchisee Audit Rights

While FDDs can be a helpful resource for prospective franchisees seeking to understand how Marketing Funds have been utilized in the past, many franchisees seek to be kept up to date on Marketing Fund expenditures after they join the system. This typically takes the form of "audit requests."

Some franchisors have their Marketing Fund audited for transparency or otherwise. An example of FDD language for a franchisor choosing to audit their Marketing Fund spending reads:

An independent certified public accountant annually audits the Advertising Fund and cooperatives funds (*i.e.*, one combined audit for all Funds). The results of the combined audit are sent to the DNAF board members and are available to you upon request.⁹¹

A common theme across the FDDs reviewed for this paper is that Marketing Fund audited reports are available to franchisees only upon request; *i.e.*, they are prepared annually, but not automatically shared with the franchisees.

Due to the costs involved or other factors, many franchisors refrain from conducting an annual audit of the Marketing Fund and, instead, expressly state that the Marketing Funds are not audited. An example of a franchisor disclosure for unaudited reports reads:

We will develop and administer advertising and sales promotion programs designed to promote and enhance the collective success of all Restaurants and will utilize your monthly national advertising fees for marketing studies and services, and the purchase of advertising time, space and materials in national, regional or other advertising media to publicize the Restaurants. Within six months of the end of our fiscal year, upon your request, we will

⁹⁰ See Planet Fitness Franchising LLC Franchise Disclosure Document, (May 25, 2023, as amended December 18, 2023), available at https://www.cards.commerce.state.mn.us/documents/%7BB069D08C-0000-C711-8380-FC34A0BC7E9A%7D/download?documentClass=FRANCHISE_REGISTRATIONS&contentSequence=0 (last visited March 28, 2024), at 44.

⁹¹ Domino's FDD at 36.

provide you with an unaudited accounting of all advertising fees we received and spent for advertising, marketing and related expenses.⁹²

Similar to the other excerpt concerning Marketing Fund information requests, this example requires franchisees to submit a written request to view the report. Additionally, some franchisors may only provide a copy for viewing at the franchisors' office.

Overall, although there are differences in the language and specific rights and procedures, the overwhelming majority of FDDs and franchise agreements reviewed for this paper included some right for the franchisees to obtain a more detailed understanding of how the Marketing Fund dollars are being spent than the generic disclosures contained in Item 11 of the FDD.⁹³

E. Promotions that Impact Franchisees and Other Sources of Disputes with Franchisees

One of the most common disputes surrounding the usage of the Marketing Fund occurs when franchisors choose to use the fund in a manner that franchisees do not like. Franchisees make substantial contributions to the Marketing Fund, and the reactions to spending can be strong in cases when franchisees believe that the Marketing Fund is being used in ways that either harm the brand or do not comply with the terms of the franchise agreement.

An example of this type of dispute arose in *Hardee's Food Systems, Inc. v. Halbeck*⁹⁴ where a Hardee's franchisee in Ottawa, Illinois brought a lawsuit against the franchisor of the Hardee's system following an advertising campaign centered around Paris Hilton.⁹⁵ The plaintiff franchisee asserted that the advertising campaign featuring Hilton was "lewd" and resulted in numerous complaints from Hardee's customers in Ottawa.⁹⁶ The franchisee survived a motion to dismiss, but Hardee's ultimately prevailed on summary judgment.⁹⁷ A similar dispute occurred in *Sherman v. Ben & Jerry's Franchising, Inc.*⁹⁸ There, the franchisee, among other things, alleged that the franchised misused "advertising money paid by franchisees to fund a political agenda rather than Ben & Jerry's products," specifically, the promotion of Al Gore's website and DVD.⁹⁹ Despite the language of the franchise agreement saying "Ben & Jerry's shall direct all marketing programs, with sole discretion over the concepts, materials, and media used in such programs and the placement and allocation thereof," the court denied the franchisor's motion to dismiss due to the franchisee's "contention that these programs did not constitute advertising...."¹⁰⁰ These cases demonstrate that franchisees are willing to

⁹² Applebee's FDD at 27.

⁹³ Though not an exact number, it is estimated that in excess of 90% of the FDDs reviewed while conducting research for this paper contained some method for franchisees to gain a better understanding of how the Marketing Fund is being spent.

⁹⁴ 776 F. Supp. 2d 949 (E.D. Mo. 2011).

⁹⁵ *Id.* at 949.

⁹⁶ *Id.* at 950.

⁹⁷ *Id.* at 954.

⁹⁸ 2009 WL 2462539 (D. Vt. Aug. 10, 2009).

⁹⁹ *Id.* at *6.

¹⁰⁰ *Id.* at *7.

bring actions against a franchisor when advertising decisions have a significant and negative impact on the franchisee's business or when advertising becomes "political" in the eyes of franchisees.

Another issue that arises within the context of marketing is campaigns that franchisees believe are not financially viable. An example of this sort of dispute can be found in *Nat'l Franchisee Ass'n v. Burger King Corp.*¹⁰¹ This case centered around a dispute regarding Burger King's implementation of a promotion requiring franchisees to offer \$1 double cheeseburgers. The franchisee association argued that requiring franchisees to sell the product at the required price was not financially viable and, therefore, should not be permissible. The franchisees asserted a number of claims, including that imposition of the \$1 pricing was a violation of good faith, and that Burger King violated the terms of their franchise contracts by unilaterally requiring lower pricing.¹⁰² While the court ultimately held that Burger King had the right to set the pricing that it did,¹⁰³ this case, again, illustrates how franchisors who make decisions that are unpopular with their franchisees may be forced to defend their actions in both judicial court, as well as the court of franchisee opinion.

In addition to disputes related to the content of the advertisement and the financial implications of honoring the offers as advertised, disputes between franchisees and franchisors concerning Marketing Funds also arise related to whether the franchisor used Marketing Fund dollars for an improper purpose,¹⁰⁴ failed to properly deposit funds into the Marketing Fund,¹⁰⁵ improperly used advertising campaigns to set franchisee prices,¹⁰⁶ used the Marketing Fund to create a different concept,¹⁰⁷ and failed to provide "adequate" advertising.¹⁰⁸

In sum, Marketing Funds can offer an efficient and effective method to promote and benefit franchisor brands and their franchisees, but they are also ripe for disputes and frequently serve to illustrate "the tensions that can beset the franchisor-franchisee

¹⁰¹ *Nat'l Franchisee Ass'n v. Burger King Corp.*, 715 F. Supp. 2d 1232 (S.D. Fl. 2010).

¹⁰² *Id.* at 1237.

¹⁰³ *Id.* at 1243.

¹⁰⁴ *Great White N. Franchisee Ass'n-USA, Inc. v. Tim Hortons USA, Inc.*, 2020 WL 8024349 (S.D. Fl. 2020) (alleging the franchisor misappropriated advertising fund money for improper purposes, such as employee salaries, paying analysts, training franchisees, research and development costs, customer service functions, and private label products for grocery stores).

¹⁰⁵ *Moghaddam v. Dunkin' Donuts, Inc.*, 295 F. Supp. 2d 136 (D. Mass. 2003) (alleging the franchisor was obligated to deposit funds it collected from underreporting franchisees into the Marketing Fund).

¹⁰⁶ *Little Caesar Enterprises, Inc. v. Smith*, 895 F. Supp. 884, 888 (E.D. Mich. 1995) (alleging the franchisor breached the franchise agreement, which gave franchisees the right to set their own pricing, by using "national advertising campaigns that mention specific prices to force its franchisees to match those prices").

¹⁰⁷ *Hendrix v. Sheridan*, No. 117,112, 421 P.3d 774 (table), at *2-4 (Kan. Ct. App. May 18, 2018) (alleging the franchisor used national marketing fund money to create another restaurant concept unrelated to the franchised system).

¹⁰⁸ *Gregory v. Popeyes Famous Fried Chicken and Biscuits, Inc.*, 857 F.2d 1474, 1988 U.S. App. LEXIS 12304 (6th Cir. Sept. 9, 1988) (alleging that the franchise agreement should be read to require the franchisor to provide "adequate" advertising, and that the franchisor provided not as much advertising and promotional assistance in the franchisee's market that the franchisee believed was necessary).

relationship.”¹⁰⁹

IV. LOCAL MARKETING

While the primary focus of franchisors and franchisees alike may be on Marketing Funds, local marketing efforts are critical to the success of many franchised businesses. Local marketing encompasses a wide variety of promotional activities, including print advertising, direct mail, locally targeted Internet-based advertising (including pay-per-click and paid search and social media),¹¹⁰ local television and radio, billboards, advertising on public vehicles, sponsorships, gift cards, promotional items, and events with local organizations.

Because it can be tailored to the surrounding market area, local marketing is one of the aspects of a franchise business that can allow a measure of creativity and permit some control by an individual franchisee. However, as in other areas, the need for brand protection and consistency of operations leads most franchisors to impose procedural and content requirements on local marketing.

A. Local Marketing Parameters

1. Required or Optional

In addition to mandatory contributions to a Marketing Fund, many franchise systems require a franchisee to spend a minimum amount for marketing and advertising in its local market. This requirement is most frequently measured either as a percentage the franchisee’s gross revenue or as a fixed monthly amount. Some franchisors impose a minimum expenditure representing the greater of the two.¹¹¹ Franchisors that require a fixed amount of local marketing expenditures, in particular, may reserve the right to

¹⁰⁹ *Broussard v. Meineke Discount Muffler Shops, Inc.*, 155 F.3d 331 (4th Cir. 1998) (reversing a \$390 million judgment against a franchisor for allegedly mishandling advertising funds).

¹¹⁰ Social media activity and other Internet-based advertising have taken on greatly increased importance in recent years. While a detailed discussion of these matters is beyond the scope of this paper, we note the existence of available materials on the subject. See, e.g., Bruno Floriani, Ama Romaine and Clay A. Tillack, *Your Ad Here: The Perils and Rewards of Advertising in Social Media*, ABA 38TH ANNUAL FORUM ON FRANCHISING W-24 (2015); Maral Kilejian, Michael S. Levitz and Robert E. Vinson, Jr., *Click to Win: Boosting the Brand with Sweepstakes and Contests*, ABA 40TH ANNUAL FORUM ON FRANCHISING W-20 30-35 (2017).

¹¹¹ See ServiceMaster Clean/Restore SPE LLC Franchise Disclosure Document (April 28, 2023), available at <https://wdfi.org/apps/FranchiseSearch/details.aspx?id=634166&hash=354924708&search=external&type=GENERAL> (last visited March 28, 2024) (“ServiceMaster FDD”), at 26 (4% of monthly Gross Service Sales); Luxottica of America Inc. dba Pearle Vision Franchise Disclosure Document (March 25, 2024), available at <https://securities.sos.in.gov/portfolio-public-view/?id=4f0df3e4-8c7a-ea11-a811-001dd8018943> (last visited March 28, 2024) (“Pearle Vision FDD”), at 18 & 21 n.3 (2% of monthly gross revenues); Anytime Fitness Franchisor LLC Franchise Disclosure Document (April 18, 2023), available at <https://wdfi.org/apps/FranchiseSearch/details.aspx?id=633768&hash=1411988131&search=external&type=GENERAL> (last visited March 28, 2024) (“Anytime Fitness FDD”), at 9-10 (\$600/\$800/\$1,000 flat fee per month, depending on market size); CK Franchising, Inc. dba Comfort Keepers Franchise Disclosure Document (December 23, 2023), available at <https://wdfi.org/apps/FranchiseSearch/details.aspx?id=635208&hash=1753930149&search=external&type=GENERAL> (last visited March 28, 2024) (“Comfort Keepers FDD”), at 10 (the greater of \$1,000 per month and 2% of Gross Revenue).

change the amount of the fee during the term of the franchise agreement.¹¹²

Other franchisors encourage, but do not require, local marketing expenditures.¹¹³ In certain industries, it is fairly common for local marketing to be an optional expenditure. For example, a number of hotel franchises do not require franchisees to spend a particular amount on local marketing (beyond regional cooperatives (see below), where participation is more often required). In this case, the franchisee may conduct local marketing if it chooses, provided that it uses only marketing materials approved by the franchisor.¹¹⁴ This approach is understandable in an industry where the bulk of the revenue is driven by online reservations platforms, and most customers of the franchised business are traveling from outside of the local area.

In some franchise systems, local marketing expenditures are recommended but optional unless the franchisee fails to meet minimum performance standards. In that situation, the franchisor may require the franchisee to make minimum local marketing expenditures.¹¹⁵

2. Fee or Direct Expenditure

In some cases, a local marketing fee is required to be paid directly to the franchisor or to a local or regional advertising cooperative, which then directs local marketing

¹¹² See, e.g., Stretch Lab Franchise SPV, LLC Franchise Disclosure Document (April 4, 2023, as amended October 2, 2023), available at

<https://wdfi.org/apps/FranchiseSearch/details.aspx?id=633554&hash=1446585113&search=external&type=GENERAL> (last visited March 28, 2024) (“Stretch Lab FDD”), Exh. A-1 at 19 (Franchise Agreement §9.2.B) (\$1,500 per month minimum local advertising spend, but “Franchisor may, at any time and on notice to Franchisee, change the amount that Franchisee must spend on local advertising and marketing activities for its Studio”).

¹¹³ See Bodyrok Franchise USA, LP Franchise Disclosure Document (July 17, 2023), available at <https://wdfi.org/apps/FranchiseSearch/details.aspx?id=635071&hash=552749039&search=external&type=GENERAL> (last visited March 28, 2024) (“Bodyrok FDD”), Exh. A at 6 (Franchise Agreement §4.3(d)) (“Although Franchisor does not require Franchisee to spend a percentage of Franchisee’s monthly Gross Revenues on the local marketing, advertising and promotion of Franchisee’s Outlet, Franchisor nevertheless encourages Franchisee to do so, using marketing and promotional materials pre-approved or otherwise authorized in writing by Franchisor”).

¹¹⁴ See, e.g., Choice Hotels International, Inc. dba Clarion Hotel Franchise Disclosure Document (April 1, 2023), available at https://www.cards.commerce.state.mn.us/documents/%7B100BE787-0000-C11B-B3CC-3829FAFCD557%7D/download?documentClass=FRANCHISE_REGISTRATIONS&contentSequence=0 (last visited March 28, 2024) (“Clarion Hotels FDD”), at 65; Holiday Hospitality Franchising, LLC dba Avid Hotels Franchise Disclosure Document (March 27, 2023, as amended April 28, 2023), available at <https://wdfi.org/apps/FranchiseSearch/details.aspx?id=633291&hash=318112198&search=external&type=GENERAL> (last visited March 28, 2024), at 50 n.9; Sonesta RL Hotels Franchising Inc. Franchise Disclosure Document (March 28, 2023), available at <https://www.wdfi.org/apps/FranchiseSearch/details.aspx?id=635576&hash=433869999&search=external&type=GENERAL> (last visited March 28, 2024) (“Sonesta Hotels FDD”), at 50-51.

¹¹⁵ See, e.g., One Hour Air Conditioning Franchising SPE LLC Franchise Disclosure Document (April 22, 2023), available at <https://wdfi.org/apps/FranchiseSearch/details.aspx?id=633863&hash=606545637&search=external&type=GENERAL> (last visited March 28, 2024) (“One Hour A/C FDD”), at 46 (“[W]e recommend that you spend at least 8% to 12% of Gross Revenue annually for local advertising and promotion of the Franchised Business (“Local Marketing”), but we do not require Local Marketing unless you fail to achieve your Minimum Performance Requirements (see Item 12) for any 12-month period. In that case, you may be required to spend at least 8% of Gross Revenue on Local Marketing during each of the following 12 months.”).

activities.¹¹⁶ In other systems, the franchisee directly selects local marketing and pays its vendors directly. The latter scenario is often the default in systems where the franchisor reserves the right to require that the franchisee participate in and contribute to local or regional advertising cooperatives, but no cooperative is yet active in the franchisee's market.¹¹⁷

Some franchisors provide local marketing assistance to their franchisees. For example, H&R Block does not impose an advertising fee separate from royalty fees, but allocates to eligible franchisees an annual amount for local marketing expenditures, equal to the greater of \$500 and 1% of the franchisee's net amount subject to royalties during the franchisor's preceding fiscal year.¹¹⁸ Other franchisors reserve the right to conduct local marketing on behalf of a franchisee that has failed to make the required minimum expenditure or to meet minimum performance requirements.¹¹⁹ Engaging in local marketing for the franchisee may create some additional risk to the franchisor, such as responsibility for compliance with applicable local law. In addition, conflict may arise if the franchisee feels that the franchisor's local marketing campaigns are ineffective or insufficiently adapted to the local market.

3. Monitoring and Compliance

Franchise systems employ a wide range of approaches to monitoring franchisee compliance with local marketing requirements. Some brands require the minimum expenditure to be met monthly, while others set an annual target.¹²⁰ Many franchisors reserve the right to require the franchisee to provide receipts for amounts spent for local marketing with third party vendors; some specifically reserve the right to audit the franchisee's books for the purpose of verifying local marketing compliance.¹²¹

Similarly, there is no uniformity regarding the consequence if a franchisee fails to meet a minimum local marketing expenditure requirement. In some systems, a franchisee that fails to spend the required amount on local marketing must pay the difference either

¹¹⁶ See Pearle Vision FDD, Exh. C-1 at 22 (Franchise Agreement §13.1) (advertising contribution paid to franchisor and allocated 75% to system-wide fund and 25% to local co-op fund); Quality Is Our Recipe, LLC dba Wendy's Franchise Disclosure Document (March 23, 2023, as amended January 23, 2024), available at <https://wdfi.org/apps/FranchiseSearch/details.aspx?id=633184&hash=213313683&search=external&type=GENERAL> (last visited March 28, 2024) ("Wendy's FDD"), Exh. B at 23 (Franchise Agreement §13.1) (local marketing spend paid to cooperative if one exists in the market); One Hour A/C FDD at 46 (disclosing the intent to implement an annual local marketing fee payable to the franchisor in exchange for local marketing materials and services); Anytime Fitness FDD at 10 (reserving the right to require franchisees to pay franchisor directly for local marketing).

¹¹⁷ See, e.g., Wendy's FDD at 19 n.9 ("The local and regional advertising fee is payable to an advertising cooperative. If there is no advertising cooperative or if the cooperative does not require contribution of the full local and regional advertising amount, expenditures are made directly by you to local advertising sources.").

¹¹⁸ H&R Block Tax Services LLC Franchise Disclosure Document (September 28, 2023), available at <https://wdfi.org/apps/FranchiseSearch/details.aspx?id=634909&hash=1124440682&search=external&type=GENERAL> (last visited March 28, 2024) ("H&R Block FDD") at 21.

¹¹⁹ See Anytime Fitness FDD, Exh. E at 10 (Franchise Agreement §6.C.2).

¹²⁰ See ServiceMaster FDD at 26 (monthly); Applebee's FDD at 27 (annual).

¹²¹ See Comfort Keepers FDD, Exh. D-2 at 38 (Franchise Agreement §8.4) ("At CKFI's request, You must submit copies of invoices for local advertising expenditures showing compliance with this Section 8.4."); Applebee's FDD, Exh. F at 9 (Franchise Agreement §8.2(b)(iii)) ("Franchisor shall have the right at all times to review Franchisee's books and records, and to require Franchisee to produce evidence of its gross sales and local promotional activities, to ensure Franchisee's compliance with this Section.").

to the Marketing Fund or directly to the franchisor.¹²² In others, the consequence of a franchisee's failure to meet the minimum local advertising spend is not specified, and thus may need to be addressed as a default under the franchise agreement.¹²³

Many franchise agreements provide no guidance on how a default for failure to spend on local marketing could be cured in a situation where there is no provision requiring payment to the franchisor or the Marketing Fund. Assuming that the franchisee should simply make the previously unspent local marketing expenditures, should the franchisee spend the entire amount of the past underpayment within the ordinary 30-day or 60-day cure period? That result, on top of the current local marketing requirement for that period, may not be rational from a marketing perspective, particularly if the default is an annual underpayment. Alternatively, should the franchisee be able to spread out the catch-up expenditures (or at least the schedule on which the advertising is published) over a longer period? In any event, it is clear that regular monitoring is key to keep franchisees on track with the required expenditures and maximize the intended benefit to the franchised business.

B. Franchisor Approval and Control of Local Marketing Materials

Given the use of the franchisor's trademarks (and sometimes copyrights) in local advertising materials, some franchisor oversight is necessary for brand protection.¹²⁴ A franchise agreement or the franchisor's operations manual may set out specific requirements for the presentation of the trademarks and substantive content (for example, that the advertising be truthful and not misleading and that it not reflect adversely on the brand), in varying levels of detail. For example, many franchise agreements require that any advertising materials created by the franchisee be submitted to the franchisor for approval prior to their use or publication.¹²⁵ In addition, many franchise agreements require any local marketing activity by the franchisee, whether required or optional, to be

¹²² See ServiceMaster FDD at 26 ("If you fail to meet the Local Advertising Commitment in any month, you must contribute the difference between your actual spend and required spend to the Ad Fund."); Applebee's FDD, Exh. F at 9 (Franchise Agreement §8.2(b)(iii)) ("any amount determined to be due...will be paid to Franchisor by Franchisee within 10 days"); Anytime Fitness FDD, Exh. E at 10 (Franchise Agreement §6.C.2) ("If you fail to spend the minimum required amount on local advertising in any calendar year, we may require you to pay the difference between what you should have spent on local advertising and what you actually spent into the General Advertising and Marketing Fund. We also reserve the right to require you to pay to us the minimum required amount for the Grand Opening Program and the minimum required amount each month for local advertising, plus our current one-time setup fee, and we will conduct the Grand Opening Program or local advertising, as applicable, on your behalf in our discretion.").

¹²³ See, e.g., Stretch Lab FDD at 33 (the minimum local advertising expenditure is "part of [Franchisee's] material obligations" under the Franchise Agreement); Comfort Keepers FDD, Exh. D-2 at 46-48 (Franchise Agreement §11.1.2) (failure to make local advertising expenditures not mentioned specifically as event of default).

¹²⁴ See, supra, Section II.A.9(b). The franchisor must describe in Item 11 of the FDD the circumstances in which the franchisor will allow franchisees to use their own advertising material. 16 CFR §436.5(k)(4)(ii).

¹²⁵ See, e.g., ServiceMaster FDD at 39 ("You must submit to us for approval samples of all advertising and promotional plans and materials that you desire to use"); Sonesta Hotels FDD at 51 ("You must submit to us samples of all advertising and promotional materials that we have not previously approved (including any materials in digital, electronic or computerized form, or in any form of media that exists now or is developed in the future) before you produce or distribute them. You may not begin using the materials until we approve them.").

conducted “in a dignified manner.”¹²⁶

Some franchisors reserve the right to utilize national Marketing Fund contributions to create advertising content and materials that may be made available for use in franchisees’ regional and local advertising. In this situation, the franchisor has greater control over the content and, as a result, may have increased potential liability for any non-compliance with applicable law.

C. Responsibility for Compliance with Applicable Law

As noted in Section I.A., there are multiple federal and state laws regulating advertising that apply to a wide spectrum of marketing activities:

- The FTC’s rules enforcing the Federal Trade Commission Act (15 U.S.C. §§41-58) require that advertising be truthful and not misleading and that the advertiser must have adequate substantiation for all claims made.
- State laws across the U.S., referred to as “Little FTC Acts,” also prohibit deceptive or unfair marketing. In addition to state enforcement, some of these statutes provide a private right of action with substantial remedies, which may include treble or punitive damages in addition to compensatory damages and attorneys’ fees.¹²⁷
- The Controlling the Assault of Non-Solicited Pornography and Marketing Act, 15 U.S.C. §§7701-7713 (“CAN-SPAM Act”) limits advertising emails to prevent deception, requiring that such emails be clearly identified as advertising, disclose the sender’s actual physical mailing address, and contain an opt-out mechanism.
- The Telephone Consumer Protection Act, 47 U.S.C. §227 (“TCPA”) restricts telemarketing calls and text messages. It prohibits, except with express prior consent of the consumer, calls that are auto-dialed using random or sequential number generators and texts sent without a human entering each number, and limits telemarketing activity to specified hours.
- Similarly, the Communications Act (47 U.S.C. §151 *et seq.*) applies to broadcast advertising, prohibiting obscene content and restricting indecent content and certain profanity during daytime hours.

¹²⁶ See, e.g., H&R Block FDD at 22 (“Any advertising or promotions by you must be preapproved by us, conducted in a dignified manner, and conform to all standards and requirements that we specify”); see also Comfort Keepers FDD, Exh. D-2 at 38 (Franchise Agreement §8.4); ServiceMaster FDD at 39; Sonesta Hotels FDD at 50.

¹²⁷ See, e.g., Ala. Code §8-19-1 *et seq.*; Cal. Bus. & Prof. Code §17200 *et seq.*; Fla. Stat. §501.201 *et seq.*; La. Rev. Stat. Ann. §51:1401 *et seq.*; Md. Code Ann. Com. Law §13-101 *et seq.*; N.Y. Gen. Bus. Law §349 *et seq.*; Ohio Rev. Code Ann. §1345.01 *et seq.*; Tex. Bus. & Com. Code Ann. §17.41 *et seq.*

- There are also multiple federal and state laws that regulate sweepstakes, contests and other promotional giveaways.¹²⁸
- While they do not have the force of law, the terms of service and other policies imposed by social media platforms also can limit the types, forms and substance of advertising content that franchisees may post on those platforms.¹²⁹ It is worth noting that franchisor policies often also circumscribe these marketing efforts.
- Industry-specific laws and regulations governing advertising, such as those applicable to the car rental industry and the marketing and sale of alcoholic beverages and food products.¹³⁰

Most franchise agreements make the franchisee responsible for compliance with all applicable laws, including laws pertaining to marketing and advertising.¹³¹

D. Local and Regional Cooperatives

Many franchise systems utilize regional or local advertising cooperatives in addition to a Marketing Fund. Cooperatives allow to franchisees to customize and adapt messaging to local or regional differences, while benefitting from the economies of scale created by pooling funds among multiple franchisees.¹³²

As noted in Section II.A.9 (d) above, the FTC Rule requires that the franchisor disclose whether a franchisee is required to participate in a local or regional advertising cooperative. If so, the franchisor must disclose a variety of information regarding such cooperatives,¹³³ including:

- the market area or membership qualifications;
- the franchisee's required contribution and whether other franchisees are contributing at a different rate;

¹²⁸ For further discussion of these laws, see Maral Kilejian, Michael S. Levitz and Robert E. Vinson, Jr., *Click to Win: Boosting the Brand with Sweepstakes and Contests*, ABA 40TH ANNUAL FORUM ON FRANCHISING W-20 (2017).

¹²⁹ For further discussion of these laws, see Bruno Floriani, Ama Romaine and Clay A. Tillack, *Your Ad Here: The Perils and Rewards of Advertising in Social Media*, ABA 38TH ANNUAL FORUM ON FRANCHISING W-24 (2015); see also Kilejian, Levitz and Vinson at 30-35.

¹³⁰ See, e.g., CAL. CIVIL CODE §1939.19 (requiring specified disclosures and disclaimers in all rental vehicle rate advertising); CO. REV. STAT. ANN. §6-1-205 (rental vehicle advertisements must include specific information regarding personal automobile insurance coverage and collision damage waivers); TEX. BUS. & COM. CODE ANN. §91.055 (mandatory charges must be disclosed in all rental vehicle price advertising and displays); Federal Alcohol Administration Act, 27 U.S.C. §201 *et seq.*; Alcohol Beverage Labeling Act, 27 U.S.C. §213 *et seq.*; 21 CFR §101.54 (regulating food nutrient content claims).

¹³¹ See, e.g., Applebee's FDD, Exh. F at 6 (Franchise Agreement §5.4(e)); ServiceMaster FDD at 73 (Franchise Agreement §5.8).

¹³² For sample advertising cooperative by-laws, see Edward Chansky, Michael Laidhold and Jill Suwanski, *The Ins and Outs of Franchise Advertising Programs*, IFA 49TH ANNUAL LEGAL SYMPOSIUM, Appendix 2.

¹³³ 16 CFR §436.5(k)(iv).

- whether franchisor-owned outlets must contribute (and at what rate);
- who administers the cooperative;
- whether there are written governing documents for the cooperative and whether they are available for franchisee review;
- whether the cooperative must prepare annual or periodic financial statements and whether they are available for franchisee review; and
- whether the franchisor has the power to form, change, merge, and dissolve the cooperative.

For example:

You are not presently required to participate in any local or regional advertising cooperative, but we may require you to do so in the future at our sole discretion. If we do, our franchisees will be required to contribute not more than 2% of their monthly Gross Revenues, based on the decision of a majority vote among its members. Such amount will be in addition to Marketing and Promotion Fees. Affiliate owned outlets may participate in and contribute to the cooperative on the same basis as franchisees. Membership in the cooperative will be defined as one group and one vote per franchisee, regardless of how many store units owned by a particular franchisee. The cooperative will be administered pursuant to By-Laws and by us. The cooperative would have to prepare such periodic financial statements as required by us and would be available for review by franchisees upon request. We will have the power to form, change, dissolve or merge cooperatives, if established.¹³⁴

1. Timing and Participation

Advertising cooperatives are generally not implemented until a critical mass of locations exists in a particular market area. As a result, franchisees in certain market areas may be participating in an advertising cooperative while franchisees in other areas are conducting local marketing on their own. In addition, some franchise systems have franchisees operating under different forms of franchise agreement containing different advertising provisions, requiring the franchisor to manage introduction or implementation of advertising cooperatives over an extended period of time. Many FDDs recite that the franchisor has not yet established any advertising cooperatives, but reserves the right to do so and require franchisee participation.¹³⁵

¹³⁴ Bodyrok FDD at 22.

¹³⁵ See Anytime Fitness FDD at 40 (“Although we currently do not, in the future we may establish local advertising cooperatives in market areas in which 2 or more Anytime Fitness clubs are operating. If we establish a cooperative in your area, or there is an existing cooperative in your area when you become a franchisee, you must participate and contribute your share to the cooperative.”); Bodyrok FDD at 22 (reserving the right to establish local or regional

In most franchise systems, if a cooperative is formed in a market area, all franchisees (and frequently any franchisor-owned outlets) are required to participate.¹³⁶ This is considered necessary to avoid free-riders – franchisees who benefit from the advertising in their market area but do not contribute to the costs. However, some brands allow franchisees an option whether to join an advertising cooperative. For example, Choice Hotels’ 2023 FDDs indicate that it supports 13 regional marketing cooperatives administered by franchisee associations. While the franchisor reserves the right to require franchisees to join in the future, participation is currently voluntary, and franchisees may opt out on an annual basis.¹³⁷

2. Administration and Decision-making

Two common complaints about Marketing Funds and programs are that they are entirely franchisor-controlled, and that they do not take regional or local market differences and preferences into account. In contrast, advertising cooperatives tend to allow greater involvement by franchisees in decision-making regarding advertising programs. The cooperative benefits from the franchisees’ understanding of their customer base and greater familiarity with factors specific to their local or regional market area. Although they involve less autonomy than local marketing decisions made by individual franchisees, cooperatives often give franchisees a greater say in how Marketing Funds are spent than a Marketing Fund administered by the franchisor.

In some brands, the franchisor permits franchisees to self-govern the cooperative once it is established.¹³⁸ In others, the franchisor exercises near-complete control.¹³⁹ However, because they are generally created and administered according to terms established in the franchise agreement, most advertising cooperatives involve at least some oversight by the franchisor.

The specific details of cooperative administration vary widely. For example, the franchisor may retain the right to form, change, merge, and dissolve cooperatives, or it may form the cooperatives but not retain the power to modify or terminate them.¹⁴⁰ Many franchisors specify the form of governing documents for advertising cooperatives; some allow the cooperatives to prepare or adapt their own documents. Voting provisions also

advertising cooperatives and require franchisees to contribute not more than 2% of their monthly Gross Revenues); Stretch Lab FDD at 33 (if local, regional and/or national co-ops are formed covering the franchised location, the franchisee must join and actively participate).

¹³⁶ See, e.g., Applebee’s FDD at 29 (“If a Cooperative is established, the members of the Cooperative for that region will consist of all Restaurants whether operated by our franchisees or franchisees of our affiliate.”); Pearle Vision FDD at 40 (“We require you to participate in the Local Co-op Fund that is established for your designated market area”).

¹³⁷ See Clarion Hotels FDD at 65.

¹³⁸ See *id.* (the cooperative, which is administered by a franchisee association, established an annual fee for participating hotels and enacts an annual budget and marketing plan; the franchisor works with the cooperative to create the annual plan and provides funding).

¹³⁹ See Pearle Vision FDD at 41 (franchisor operates and administers the cooperative in accordance with its policies and form of charter, which it may change at any time, and can overrule any decision of the cooperative that it believes not to be in the best interest of the brand).

¹⁴⁰ See *id.* (“We have the right to dissolve, merge, or change the structure of any Local Co-op Fund.”); Applebee’s FDD at 29 (“We will determine in advance how each Cooperative will be organized and governed and when it must start operation. Once established, we do not have the right to dissolve, merge or change the structure of the Cooperatives.”).

vary among franchise systems – some cooperatives allocate one vote per franchisee, others specify one vote per location.¹⁴¹

In some franchise systems, contribution levels are set by the franchisor, and in others by a vote of the members of the cooperative.¹⁴² Generally, any franchisor-owned locations within the market area participate equally with franchised locations.¹⁴³ Most brands view cooperatives as an extension of local marketing, and franchise agreements often specify that a franchisee's contributions to a cooperative count toward the minimum local advertising contribution.¹⁴⁴

3. Contributions and Potential Controversy

Local marketing expenditures are often made by individual franchisees for the benefit of their respective locations, so that variations in spending levels do not tend to create conflict. However, where a cooperative is formed, differing requirements among forms of agreement may create inequality of contributions within the same local market. In addition, some franchisors reserve the right to adjust local advertising contributions in particular circumstances, including through incentive programs. Finally, franchisors may utilize Marketing Fund contributions to create advertising content and materials for use in regional and local advertising; the end result may be a situation where more densely franchise-populated markets stand to benefit from contributions by franchisees in less concentrated areas. All of these scenarios can lead to controversy among franchisees. Franchisors are well-advised to understand and focus on these issues to ensure fairness in the functioning of cooperatives and other local marketing efforts.

V. CONCLUSION

As demonstrated by the broad variety of Marketing Fund and local marketing requirements implemented by franchisors across franchise systems, there is no “one size fits all” approach to franchise marketing. Franchisors must ensure that they properly disclose national, regional and local marketing requirements in their FDDs, so that franchisees can make informed purchasing decisions. Any proposed changes, including modernization of franchise marketing platforms and new marketing initiatives, should be carefully evaluated to verify that the changes are permitted under the existing franchise agreements. If not, franchisors need to take into account any limitations in existing franchise agreements and understand that reaching system-wide participation may require time (until older franchise agreements are replaced by current forms at renewal)

¹⁴¹ See Bodyrok FDD at 20 (one vote per franchisee); Pearle Vision FDD at 41 (one vote per location).

¹⁴² See Applebee's FDD at 29 (“We have the right to increase or decrease your required advertising contributions or payments to the Fund, to a Cooperative, or for Local Advertising.... However, we will not increase the total amount of your required contributions or payments to more than 5% of Gross Sales (Franchise Agreement, Section 8.2).”); Comfort Keepers FDD at 11 (amount of required contribution to cooperative would be determined by the cooperative members); see also Wendy's FDD at 18-19 n.6 (franchisor conducted a vote of its franchisees on the allocation of the required national and local or regional cooperative fees).

¹⁴³ See, e.g., Wendy's FDD at 38 (franchisor contributes and votes in the same manner as franchisees in those cooperatives where the franchisor is a member).

¹⁴⁴ See Applebee's FDD at 29 (“Your payments to the Cooperative apply toward satisfaction of your Local Advertising requirement.”); Comfort Keepers FDD, Exh. D-2 at 38 (Franchise Agreement §8.3) (amounts paid in connection with participation in an advertising cooperative will count toward the amount the franchisee must spend on local advertising).

or offering incentives to encourage franchisees operating under older forms of franchise agreement to agree to participate. Franchise advisory councils and franchisee associations may assist a franchisor in making its case for change, if the franchisor can persuade franchisee leaders and thus obtain buy-in from the franchise system. A franchisor's failure to manage these concerns effectively can result in significant disputes over systemwide marketing. Maintaining good communication and relationships will generally serve a franchise system well and allow franchisors and franchisees to work together to increase brand awareness and the success of the franchise system through national, regional, and local marketing programs.