



Focus **on** Franchising

Published by the Franchise and Distribution Practice Group of Farrell Fritz, P.C., Attorneys at Law

Welcome!

Welcome to our sixth edition of Focus on Franchising. We have quite a lot of information in this issue, so we'll leave this part brief. As always, your comments and suggestions for future articles are welcome. Please contact us at franchise@farrellfritz.com.

James M. Wicks, Esq.
Harold L. Kestenbaum, Esq.

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The Right Marketing Materials For Franchise Sales Success

By Mark C. Siebert



(This is the first of a two-part series. It was originally published in *Franchising World*.)

How do you create the marketing pieces that will jumpstart your franchise sales efforts?
It starts with the story. . .

You need to create a powerful brand story that is compelling on both an emotional and logical level. It must inspire, motivate the prospect to action, and answer questions such as "What do I get for my money?" and "Why do I need you?"

Once the story is crafted, it should be communicated consistently through a number of methods, including:

The franchise brochure - Despite living in the digital age, the franchise brochure still remains the undisputed king of franchise marketing materials and the one absolute essential. Not only does the franchise prospect pour over every inch of it, this brochure will be scrutinized by their spouses, lawyers, accountants, and investors. Go four-color with quality copy and design by a company that knows franchising; use excellent photography and print stock. Good brochures can cost \$4 - \$5 apiece in quantity, but are well worth the price. Consider a print shop with digital printing capabilities if you prefer fewer copies (under 1,000).

The mini-brochure - Print a tri-fold brochure for use as a trade show handout, direct mailer, or in-store promotion. Printed in quantity, a four-color mini-brochure can be produced for as little as 30 cents per piece, making it economical.

The web site - The obvious digital essential, the franchise web site is part advertisement and part promotional material. Its purpose is both to generate franchise leads and to promote the franchise to people who already know of the opportunity. A good web site is the cost of entry these days - franchisors without a professional-looking web site will lack credibility. A tip: do not provide too much detailed information on your web site unless you require the prospect to provide contact information to view it. Your goal is to prompt contact and harvest leads, not answer every question.

The franchise e-brochure - Often designed in a Flash format, e-brochures are about the same size and dimensions as a standard business card and are designed to run in the CD-ROM or DVD drive of most computers. The message can be compelling and can include video clips and voice-over narration. Production costs of under a dollar per piece make them an economical way to deliver a tremendous amount of information in a small package, but they have the

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By Harold L. Kestenbaum, Esq.

414,923 And Counting. . .

Based on some recent reports, franchising has clearly taken over the small business world and become a great force in our economy. According to a recent survey published by Bond's Franchise Guide, there are roughly 2,037 franchise companies in the U.S. (I believe there are probably many more than that). That same survey lists 414,923 actual franchised units operating in the U.S. - a staggering number when you think about it!

For those who are on the fence about whether to franchise their business, I think that in today's economy the decision is a virtual "no-brainer"- assuming of course that you have the necessary capital and experience. How else can you expand your business using someone else's capital and sweat equity? I challenge the many skeptics who believe franchising is a flawed method of growing a business. Rather, I believe it is clearly the most effective business model for growth in the marketplace today. Clearly, successful franchisors understand that what motivates them is not greed, but the ability for them and their franchisees to be successful. A one-way street is never a strategy that works in the long run. Both parties have to succeed or else the system will fail.

And for those of you who are franchising and may be discouraged by the short-term results, don't be! It takes time to develop a successful franchise program; it does not happen overnight. Remember the tortoise and the hare? Patience rules the day when it comes to expanding a brand via franchising.

FTC Rule Update

On the FTC Rule change front, it appears to me that these changes, or a variation of the proposed changes, will not take effect until the middle of 2005, and will be phased in during the end of 2005 or early 2006. The real question, which I have not seen publicly

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Alphabet Soup Confusion: Sorting Out The Revised FLSA Regulations

By A. Kathleen Tomlinson, Esq.



The alphabet soup of federal employment laws has recently been stirred once again by changes to the FLSA ("Fair Labor Standards Act"). Just when you thought you finally understood the differences between "exempt" and "non-exempt" employees, the U.S. Department of Labor has come along with revised regulations that determine the employees to whom you are required to pay overtime wages.

As an employer, how do the revised regulations affect you? Historically, most employers who have been penalized by fines and penalties in Department of Labor audits have gotten into difficulty based on the mistaken perception that if a worker is paid a salary (in contrast to hourly wages), he or she is "exempt" from the FLSA overtime requirements. However, unless that salaried employee qualifies for one of the so called "white-collar" exemptions under the FLSA, an employer must pay that person overtime pay.

The revised regulations took effect on August 23, 2004, but several bills have been introduced in Congress to block or rescind portions of the new rules. These bills are still pending. Despite the political wrangling, employers should take steps to ensure they comply with the revised regulations. To determine "exempt" status, the new regulations rely on three tests: (1) the salary level test; (2) the salary basis test; and (3) the job duties test.

Under the new salary level test, to be exempt, an employee has to earn at least \$455 weekly and \$23,600 annually, as compared to the previous threshold of \$155 per week and \$8,060 annually. Moreover, the employee must receive a standardized weekly paycheck and be paid the full salary for any week in which he or she performs any work. This minimum salary requirement applies to all workers, full- and part-time.

An employee's "primary duty" at work now determines whether the employee is exempt under the new job duties test. The "executive," "administrative" and "professional" exemptions must satisfy the primary duty test of each. While the "executive" and "professional" exemption tests are fairly straightforward, the "administrative" exemption requirements are potentially confusing. To qualify as exempt, the administrative employee must perform non-manual work related directly to the management or general business operations of the employer. In addition, the employee's primary duty must involve the exercise of discretion and independent judgment with respect to "matters of significance" for the employer.

There is a 10-factor test to determine whether an employee is exercising discretion and independent judgment. No definition of "matters of significance" is provided in the regulations, and that omission will likely lead to requests for future rulings.

Highly compensated employees (those making \$100,000 or more annually) performing office or non-manual work are now exempt if they regularly perform at least one of the duties of an exempt executive, administrative or professional employee.

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What should franchisors do to ensure compliance? The first step is to conduct a thorough review of all payroll practices. The second step is to update all job descriptions. This is one of the items the Department of Labor looks for in every audit. The job descriptions need to accurately reflect exactly what the individual does on a day-to-day basis. Employers need to review their handbooks and policy statements to ensure that provisions impacted by the FLSA comply with the new regulations. With regard to non-exempt

employees, companies need to ensure that they have an established timekeeping method that is complete and accurate.

These measures not only help avoid risk, they begin to sort out confusion that the FLSA formulas may compound. In the end, when in doubt, consult a professional who works with these issues regularly. For further information on the 10-factor test, or for employee handbook guidelines, please contact franchise@farrellfritz.com.

LITIGATION NOTES



How Well Do Restrictive Covenants Protect Your Franchise?

By Eric W. Penzer, Esq.

Perhaps not as well as you think. Franchise agreements often contain post-term restrictions preventing a franchisee from competing with the franchisor after the franchise agreement ends. These “covenants not to compete” are, generally speaking, disfavored in the law. In the employment context, the restriction will be enforced only if reasonably limited in duration and geography, and only to the extent necessary to protect the employer from unfair competition which stems from the employee’s use or disclosure of trade secrets or confidential customer lists. From a practical standpoint, absent a showing that trade secrets exist, restrictive covenants are virtually impossible to enforce.

But the courts apply different criteria for enforcing restrictive covenants in non-employment contexts. For example, when parties agree to a restrictive covenant related to the sale of a business, the restriction will generally be enforced if it is reasonable in duration and geographic scope.

In the franchise post-termination context, a covenant not to compete is likely to be enforced when its scope is reasonably related to protecting the franchisor’s know-how and its ability to place new franchisees in the same territory. Courts have recognized the danger that former franchisees will use the knowledge they gained from the franchisor to serve its customers, and that continued operation under a different name may confuse customers, thereby damaging the goodwill of the franchisor. Often, if a court determines that a covenant is unreasonable in scope, it will “blue pencil” it, enforcing it only to the extent reasonable.

A leading New Jersey federal case on the subject involved the termination of a rapid lubrication service center franchisee caught underreporting sales figures. There, the court analyzed

the enforceability of the covenant under the lenient “sale of a business” standard. The court determined that the franchisor had a legitimate interest to be protected through enforcement of the covenant, i.e., its interest in being able to place a new franchisee at or near the location of the old franchisee. The court next determined that the scope of the covenant was excessive. While the covenant originally restricted the franchisee from operating a competing center within 10 miles of its former location or any other of the franchisor’s locations, the court “blue penciled” the covenant, i.e., narrowed its scope, to restrict the former franchisee from competing within five miles of its former location. Moreover, the court limited the duration of the covenant to 10 months. This period was, in the court’s estimation, sufficient time to permit the franchisor to place a new franchisee in the area.

The relationship between a franchisor and franchisee lends itself nicely to the enforcement of restrictive covenants. Usually, the franchisor provides the franchisee with training and confidential operating manuals, and, in doing so, extends to the franchisee the knowledge and ability to launch a business. Post-termination, courts generally recognize that a franchisor has a legitimate interest in preventing a former franchisee from capitalizing on customer relationships built as a part of the franchise system, which would have the effect of harming the franchisor’s good will and reputation. Moreover, the former franchisee’s continued operation of a competing business is likely to jeopardize the franchisor’s ability to place a new franchisee in the same territory. By enforcing restrictive covenants, courts recognize the importance that non-compete provisions have on the continued success and operation of franchise systems.



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addressed, is how the individual registration states intend to handle adoption of the Rule changes. As I mentioned in our last newsletter, the biggest expense and headache for multi-state franchisors will be how long it takes for each registration state to adopt these changes. The longer that process takes, the longer each franchisor will be forced into utilizing multiple UFOC's. Not a pretty picture by any means; however, it would behoove the states to adopt these Rule changes as expeditiously as possible so that the franchise community can finally have one basic document to use. My guess is that they will try very hard to accomplish this.

Farrell Fritz Briefs

Our firm is pleased to announce that Edwards & Duggan has merged into Farrell Fritz. William H. Duggan, Jr. joins us as counsel. He and his staff are located in East Hampton, NY, which is now our fifth office in New York.

We welcome Jodi L. Gladstone as an Associate in our Real Estate Practice Group.

Events Calendar

March 6 - 9

IFA 45th Annual Convention. For further information, go to www.franchise.org

March 18

Farrell Fritz Quarterly Franchise Forum. To reserve a place, contact Helen Rajcooar: phone, 516-227-0641; email, hrajcooar@farrellfritz.com

April 8 - 10

IFE Expo 2005. For further information, go to www.franchiseexpo.com

April 21 - 22

IFA Franchise Development Super-Session: "The Nuts & Bolts for Building Your Brand." Farrell Fritz is pleased to sponsor the 4/21 breakfast. For further information, go to www.franchise.org

www.farrellfritz.com

Kudos

John J. Barnosky has been named as one of the Best Trusts & Estates Lawyers in America by American Lawyer.

In 2005, and for his second consecutive year, **Harold L. Kestenbaum** has been named one of the top 100 franchise attorneys in North America, based on a survey conducted by Franchise Times. Harold is also the first U.S. attorney to join the International Franchise Lawyers Association (IFLA). He will facilitate the Business Roundtable, "Issues to Consider When Growing Your System with Multi-Unit Operators/Area Developers" at the IFA's 2005 annual convention.

Lyle C. Mahler, an attorney in our Franchise & Distribution Practice Group, has been named Counsel.

A. Kathleen Tomlinson has been recognized as one of the 2005 Ten Leaders of Long Island in Civil Trial & Employment Law in a survey conducted by Digital Press International. Kathleen also earned the "Ten Leaders" distinction in their 2003-2004 survey.

THE RIGHT MARKETING MATERIALS

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disadvantage of requiring a computer to deliver that message. E-brochures can double as a franchisor's web site and can even require some data capture to access them. Some franchisors use them as e-mail attachments for more immediacy. Not an essential, but a strong piece that demonstrates you are state-of-the-art.

E-mail response messages - The Internet can create a massive amount of unqualified leads to sift through. To solve this problem, we recommend a system of customized auto-responding follow-up e-mail messages that encourage interested prospects and filter out unqualified inquiries without wasting valuable staff time. The appropriateness of this strategy varies from franchisor to franchisor.

The franchise sales videotape - An 8-10 minute, professionally produced videotape is hard to beat for effectiveness. With sound, music, narration and vivid videography, a quality video draws the prospect into the franchise experience like no other medium. It is also great for Discovery Day, group presentations, and for sending to distant prospects. It also enables you to deploy the most powerful secret weapon of franchise sales: enthusiastic testimonials from happy, successful franchisees. From a production standpoint, development of this video allows an easy transition to the e-brochure, which is less expensive than the \$3 per piece cost, per tape.

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