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# The ABA Consumer Protection Conference

### *Dr. Jekyll's Wife and Other Stories*

**By David W. Koch**

Imagine your franchise lawyer sitting in a lecture hall with three of the five current commissioners of the Federal Trade Commission, two of the three current FTC Bureau directors, and two dozen other FTC staff members. Make you nervous? Now add the head of the Justice Department's Civil Division, a federal judge, and for good measure, the Privacy Commissioner of Canada. Breaking into a sweat?

Relax, there is nothing to fear. The occasion for the gathering at George Washington University ("GWU") on Feb. 3 was the American Bar Association's Consumer Protection Law Conference. The full-day program, sponsored by the Section of Antitrust Law, featured seven distinguished panels and plenty of issues of interest to the franchising community.

Why should franchise systems' ears prick up? For starters, savvy franchisors should understand the larger consumer protection context in which their principal federal regulator operates — especially when most of the top decision-makers show up.

## Advertising Issues

The liveliest issue of the day was advertising substantiation. Current and former directors of the FTC Bureau of Consumer Protection squared off in debate

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# Hotel Franchises Face Rising Bed Bugs Claims

**By Kevin Adler**

When health and environmental experts convened in Washington, DC, on Feb. 1-2 for the Second National Bed Bug Summit, the message was clear that bed bugs are an increasing health menace. "In recent years, public health agencies across the country have been overwhelmed by complaints about bed bugs," said Bob Perciasepe, deputy administrator, U.S. Environmental Protection Agency ("EPA"), at the start of the summit.

For lodging industry franchises, bed bugs are a business challenge and a potential source of litigation. "No one is keeping an exact count of the number of cases, but claims are definitely on the rise," said Christian Hardigree, associate professor and chair of the Department of Hotel Management at the William F. Harrah College of Hotel Administration at the University of Nevada, Las Vegas.

Hardigree said that many lawsuits are "nuisance claims" that are settled for small amounts of money. Alleged victims don't have permanent injuries and did not seek medical attention, but the hotel operator does not want the negative publicity of a lawsuit. "The damages aren't great, so many people are making claims on their own without working with an attorney," she said.

One factor that has been limiting damages is the relatively low danger from bed bug bites; according to the EPA, bed bugs do not carry diseases and few people have severe allergic reactions. But the bites do cause great discomfort, and a sleeping person can get scores of bites in an evening because the bugs inject an anesthetic and anticoagulant so that the victim does not feel the bite when it occurs. "Bed bugs cause a variety of negative physical health, mental health, and economic consequences," said Perciasepe.

Benjamin West Janke, attorney with Baker Donelson Bearman Caldwell & Berkowitz, PC (New Orleans), has found that, to date, damage awards against hotel operators typically have been for compensatory damages only and have been $5,000 or less. "But with the issue becoming sensationalized in news stories, a plaintiff could possibly claim emotional distress and receive more in damages than is warranted solely for physical harm," he said.

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## *In This Issue*

## *ABA Conference*

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over whether the FTC has raised the bar for substantiation of health claims in advertising. J. Howard Beales, now a GWU professor, charged that FTC settlements in 2010 with Nestle, Iovate, and Dannon mark a major policy change — to the effect that specific disease-prevention claims are now prohibited unless they have been approved by the FDA. Current Bureau Director David Vladeck emphatically denied that interpretation. He maintained that the settlements merely tightened the FTC's traditional consent order language requiring competent and reliable scientific evidence. The settlements do not, he continued, require a company to get FDA approval before making a claim unless the advertiser is already under FTC order.

Richard Leighton, of Keller and Heckman LLP, said that Vladeck's answer reminded him of Dr. Jekyll's response to his wife when she asked him what he had done the night before: "Oh, the usual." The FTC's pending litigation with POM Wonderful 100% Pomegranate Juice is expected to shed further light on the issue.

A panel including Senior District Judge Thomas Ellis III of the Eastern District of Virginia debated a different advertising question: whether challengers of competitors' advertising claims are better off in court or in the self-regulatory process of the National Advertising Division ("NAD") of the Council of Better Business Bureaus. Two practitioners and the deputy director of NAD concluded that both have advantages, depending on the degree of urgency and the type of relief desired.

### Privacy

FTC Commissioner Julie Brill led off a privacy panel by tracing the history of FTC privacy enforcement and summarizing the preliminary staff report released on Dec. 1, 2010, which unleashed a torrent of debate on the "do not track" concept. She was encouraged that the report has "ignited" industry to act on behavioral advertising, a welcome change from what she called the "slow" response since the FTC first called on the industry in February 2009.

Leslie Harris, president and CEO of the Center for Democracy and Technology, was disappointed that the report did not call for baseline federal privacy legislation, but nevertheless predicted a "tsunami" of privacy activity on Capitol Hill. She credited the Department of Commerce green paper on privacy, released just weeks after the FTC staff report, for framing the business case for privacy — a perspective very important to Congress. But she called "do not track" merely a slogan at this point, and thus not a reliable cornerstone for public policy development.

### Liability for the Acts of Others

Slightly closer to home for franchisors, a panel including FTC Commissioner Edith Ramirez and Shelly O'Callaghan, assistant general counsel of International Dairy Queen, discussed liability for the acts of others. The discussion highlighted two FTC cases involving brand owners' use of independent marketing companies that violated federal telemarketing laws in contacting consumers. In *Direct TV*, settled by consent order, the FTC alleged that Direct TV was liable for both "causing" and "assisting or facilitating" the violations. Direct TV agreed to pay a $5 million civil penalty. The other case, *Dish Network*, is still ongoing. Albert Shelden, senior assistant attorney general of California, urged the audience to look at the *Direct TV* order for guidance on the FTC's expectations.

### Financial Services

Joe Farrell, director of the FTC Bureau of Economics, and Joel Winston, associate director in charge of the Division of Financial Practices in the Bureau of Consumer Protection, were on a panel examining the dramatic shift in the legal landscape for financial services. They explored how the new Consumer Financial Protection Bureau ("CFPB"), housed

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# *Bed Bugs*

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Even small, nuisance claims can add up if multiple incidents occur at the same hotel. Also, Hardigree pointed out, insurers are tightening their rules on paying for claims by excluding claims for vermin, or giving hotel operators the choice of buying expensive riders to retain that coverage. Sometimes, hotel operators can buy riders for loss of business if they have had to close rooms or lost bookings due to bed bugs.

One lawsuit several years ago illustrated circumstances under which punitive damage awards might be awarded far in excess of compensatory damages. In *Mathias v. Accor Econ. Lodging*, 347 F.3d 672 (7th Cir. Ill. 2003), a trial court found compensatory damages of $5,000, but assessed punitive damages of $372,000 against the hotel operator because it knew about the problem and chose not to undertake an inexpensive solution, said Janke. The ruling was affirmed by Judge Richard Posner in the U.S. Court of Appeals for the Seventh Circuit.

In *Accor*, a room had been found infested with bed bugs and closed to usage, with the classification of "Do not rent until treated." However, it was rented to two guests without being treated. Also, the hotel operator chose to spray only the room in which bed bugs were found, rather than to spray the entire property, even though the cost would have been only $500.

"The defendant argued that at worst it was guilty of simple negligence, and thus plaintiffs were not entitled to any award of punitive damages," said Mitch Miller, principal, Miller Law Group, P.C. (Palo Alto, CA). "It also complained that the award was excessive. The court disagreed, stating 'the evidence of gross negligence, indeed of recklessness in the strong sense of an unjustifiable failure to avoid a known risk, … was amply shown.'"

"In *Accor*, the court found that the defendant refused to address the problem," added Janke. "It was intended to be a wake-up call to the hotel operator. And remember that *Accor* did not involve mental anguish claims, and there's nothing to say that a court won't allow that down the line. No hotel or franchise wants to face that."

(For summaries of two other significant bed bugs decisions, see "Significant Bed Bugs Litigation" on page 4.)

## Scale of Problem and Development of Treatments

No organization tracks the number of bed bug infestations reported annually, but survey data from the National Pest Management Association ("NPMA") provide some sense of the growth of the problem. In 2009, bed bug treatment in the United States generated about $258 million in revenue, up from $98 million in 2006, according to NPMA.

In a 2010 NPMA survey, more than 95% of pest control professionals reported that they provided bed bug treatments in the last year, as compared to fewer than 25% in 2000. "Also, though this is anecdotal, the respondents said that while they might have been doing one or two treatments a year in the past, they are doing one or two a month, a week, or even per day now," said NPMA spokesperson Missy Henriksen.

In the survey, 76% of NPMA survey respondents described bed bugs as the hardest pests to treat. "They hide, they are nocturnal, and they can lay dormant for a year," said Henriksen.

Making matters more complicated, the pest control industry and the EPA do not have a consensus on how to treat for bed bugs. The EPA has noted that chemicals-based approaches have backfired to some degree, as bed bugs are developing resistance to some pesticides, and some chemicals that might kill bed bugs potentially pose health risks when used in indoor applications. In June 2010, the EPA denied a request for waiver from the state of Ohio to allow for the "spot use" of the pesticide Propoxur in cracks and crevices of buildings, calling it "toxic for children."

Best practices developed by NPMA and others are guiding lodging operators. NPMA's latest best practices manual was released in January 2011 with input from a variety of industry stakeholders, as well as government and academia, said Henriksen. It can be found at www.pestworld.org.

NPMA also is working with government officials on several regulatory matters that could have an impact on the problem. It is seeking to increase research funding for bed bug control. It has asked the EPA to standardize the approval process for new products for bed bug treatment and to consider product waivers, such as Propoxur.

Also, to reduce the confusion faced by individuals and businesses beset with bed bugs, NPMA has asked the Federal Trade Commission to vigorously enforce advertising claims about bed bug treatment products and services. "Whenever you see a business with this type of growth rate, people will enter it and make wild claims," said Henriksen. "We don't want individuals or businesses to be cheated."

Finding effective treatments is definitely a priority for the lodging industry, said Hardigree. "This has the potential to be the snake oil pitch of the 21st century," she said. "I work with a number of entomologists, and they say the data are not there to back many of the treatment claims. There's nothing that you can legally spray that will fix the problem, and hotel operators don't know what to do."

A proactive approach to searching for bed bugs, followed by a multitiered approach to removing them, is best, she said. Hardigree said that some hotel operators offer bonuses to house-cleaners who find bed bugs, or they conduct all-property checks every few weeks.

## Franchisors' and Franchisees' Responses

Given the widespread nature of the problem and the potential claims, franchises are moving quickly to implement solutions. And having a well-designed plan for stopping infestations when they are found will

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**Kevin Adler** is associate editor of this newsletter.

## *Bed Bugs*

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help a hotel operator make its case in court.

But the very nature of the franchise relationship adds a layer of complexity that is absent for other businesses, such as apartment buildings. "Not only are lodging franchises struggling to formulate a solution, but it is made more complex because of the issue of control," Janke said. "The franchise needs to consider how much should be handled at the franchisor level, and how much responsibility should be delegated to the franchisee."

Typically, hotel franchises leave franchisees responsible for pest control. The franchisor sets standards that the franchisee must meet, and it reserves the right to inspect, monitor, or evaluate the franchisees' compliance with such standards. "In the franchise context, this approach manifests in operations manual language that alerts the franchisee to this responsibility," Janke said. "More specific language runs the risk of crossing the threshold into 'control' that will offer claimants the chance to take the franchisor, as well as the operator-franchisee, to trial."

The ease with which bed bugs can be transferred from one place to another and create infestations has created some surprising situations, according to Hardigree. For example, her hotel clients are seeing a rise in workers' compensation claims by cleaning and maintenance staff that they were infested while on the job. Those bugs then infest workers' homes, causing them additional discomfort and expense.

Conversely, some hotel operators are finding that their workers are unintentionally bringing bugs from their infested homes. Hardigree said that some hotels have responded by providing interest-free loans for staff to get their homes decontaminated. "For people living paycheck to paycheck, there's no money for an exterminator, and they don't want to admit it to their employer," said Hardigree.

Even training of front-desk staff can be affected by bed bugs. When Hardigree arrives at a hotel, she asks if the hotel has had any complaints by guests about bed bugs. "I don't do this because I expect them to be honest, but I do it to change the damages I can seek," she said. "If they lie to me, that's fraud."

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## Significant Bed Bugs Litigation

**By Mitch Miller**

In addition to *Mathias v. Accor Econ. Lodging*, attorneys should be aware of these two decisions related to bed bug infestation.

### Pesticide Exposure Counts, Too

*Duarte v. Cal. Hotel & Casino*, 2008 U.S. Dist. LEXIS 69991 (D. Haw. Sept. 5, 2008).

The court granted the defendant's summary judgment motion regarding the statute of limitations as to the bed bug bites because the complaint was filed after the applicable statute expired, which had begun running on the date of the injury — an obvious unsightly rash. The plaintiff noticed the rash and woke up feeling as if something stung or bit her. She was transferred to another room after she found the linens in her room had been removed and the bed mattress turned over. Further, the plaintiff confronted the defendants during and after her stay about whether there were insects in the room.

Based on these facts, the court held that the plaintiff knew, or at the very least had notice, that the hotel provided her a room with insects in it, which had caused her injuries. Thus, the plaintiff should have filed any claim for injuries from exposure to bed bugs within two years after her injury.

However, the court denied the defendant's summary judgment motion regarding the statute of limitations for the insecticide exposure because it was a question of fact whether the plaintiff knew or should have known about the exposure to chemicals. The court found no evidence indicating that the plaintiff knew, or should have known, that she was exposed to chemicals, because mere suspicions are neither knowledge nor notice.

### Lack of Notice Does Not Automatically Negate Duty

*Prell v. Columbia Sussex Corp.*, 2008 U.S. Dist. LEXIS 84536 (E.D. Pa. Oct. 20, 2008).

There are numerous ways that constructive notice may be established, most or all of which will likely result in a triable issue of fact that will overcome any motion for summary judgment. The court denied the defendant's summary judgment motion because it was a question of fact whether the defendant had actual or constructive notice of bed bugs in the plaintiff's room.

The plaintiff complained of small, tick-like, reddish-brown insects in his room each morning of his stay. Clerks repeatedly assured him that the matter would be remedied, and that exterminations were periodically done. A juror could reasonably find the defendant had actual notice if he/she inferred that the defendant's staff looked into the problem as promised and observed the same insects seen by the plaintiff. A reasonable juror could likewise find that the defendant had constructive notice by finding that after the plaintiff reported the insects, the defendant had a duty to make reasonable inquiry by examining the plaintiff's room, whether or not it actually did so, and that such inquiry would have revealed the problem and obligated the defendant to identify and remedy it.

Thus, the court denied the defendant's summary judgment motion based on lack of notice.

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# COURT WATCH

By Cynthia M. Klaus
and Meredith A. Bauer

## Preliminary Injunction Prevents McDonald's Franchisee Termination

As always, a recent case reminds us that franchisors should carefully watch their representations to franchisees at the time of contracting. Although not expressly provided for in any written agreement, a California court recently decided that a franchisee of several McDonald's restaurants was reasonably likely to succeed on the merits of his claim that the franchisor had agreed to renew three franchises with fewer than five years remaining on the agreements when it approved of the franchisee's purchase of the restaurants from another franchisee. *Husain v. McDonald's Corp.*, Bus. Franchise Guide (CCH) ¶ 14,530 (Cal. Super. Ct. Dec. 20, 2010).

Husain has been a McDonald's franchisee since the early 1980s. In 2005, he owned McDonald's locations in the San Francisco area, and he entered into an agreement with another franchisee to purchase seven more. A McDonald's franchise agreement typically has a 20-year term, but some of the agreements for these seven franchises had a less than a five-year term remaining at the time that they were purchased by Husain.

As part of the purchase, McDonald's executed an assignment agreement, authorizing the assignment of the former franchisee's agreements to Husain. Husain believed that, as part of the purchase, McDonald's had agreed that it would extend the terms of the franchises with fewer than five years remaining for an additional 20 years, although this was not expressly provided for in writing.

Shortly after the assignment, McDonald's sent a proposal to Husain offering an extension of the lease of one of the franchises in exchange for a promise to upgrade the location. Husain stated that he accepted the proposal and returned it to McDonald's; McDonald's never received the acceptance.

In 2007, Husain had financial difficulties, and McDonald's informed him that he was not qualified "for growth or rewrite." Nonetheless, Husain obtained a refinancing loan, approved by McDonald's, using the franchise agreements as security. In 2008, McDonald's informed Husain of several improvements that needed to be made at one of the locations (the Novato franchise) that had an expiring agreement. Husain eventually made the improvements, but not in the manner or timing McDonald's wanted. In December 2008, McDonald's denied Husain a new 20-year term for the Novato franchise. Husain filed suit, and both parties moved for injunctive relief relative to the continued operation or termination of three of Husain's franchises, including the Novato franchise. The court held an extensive evidentiary hearing.

Husain testified that he had been advised that the three franchises would be renewed, and that he would not have purchased the franchises and invested $10.5 million in them if he knew the term would be so short. McDonald's maintained the position that circumstances had changed in the three years since the purchase, and Husain now was not qualified for renewal.

In interpreting whether the assignment agreement required renewal, the court found it would be "extraordinary, harsh and unjust" if Husain was expected to make such a large investment in purchasing franchises that would expire within five years. It also noted that if McDonald's did not plan to renew the franchises, it could have made that clear in the agreement. Further, the court did not agree with McDonald's that the circumstances had significantly changed. Therefore, on the likelihood-of-success factor for injunctive relief, the court believed that Husain was more likely to succeed on the merits.

In addition, the court declared that the balance of harms tipped "strongly in Husain's favor." The court noted that Husain would suffer significant financial difficulties if the franchises were terminated, and his ability to remain in business would be threatened by the loss of the three franchises because of the synergies across all of his locations. In contrast, the court found that the potential harm to McDonald's was not nearly as significant. Although the court recognized that unauthorized use of trademarks can be grounds for injunctive relief, it did not believe that Husain was a current threat to McDonald's goodwill or trademarks. Therefore, the court denied McDonald's motion and granted Husain's motion for a preliminary injunction, allowing him to continue operating the three franchises pending a trial on the merits.

## Franchisor Not Jointly Liable for Labor Claims Brought By Franchise Employee

Since the federal court opinion in *Awuah v. Coverall North America, Inc.* was released, an issue at the top of mind for those in the franchise industry is whether a franchisee can be characterized as an employee of the franchisor. A recent case in which a franchisee's employee named the franchisor in a lawsuit under a joint employer theory now serves to remind franchisors that they must also tread carefully in considering their dealings with employees of their franchisees.

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## Court Watch

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In *Reese v. Coastal Restoration and Cleaning Services, Inc. d/b/a SERVPRO of Pearl River/Hancock & SW Harrison Counties et al.*, Bus. Franchise Guide (CCH) ¶ 14,523 (Dec. 15, 2010), Leigh Reese brought suit against his employer, Coastal, and he also named SERVPRO, the franchisor, as a party to the suit under a joint-employer theory. When Reese was originally hired by Coastal, he worked as a non-exempt employee paid on an hourly basis. Reese subsequently obtained a number of pay increases, and he eventually was promoted to a salaried management position. As part of his new role, Reese was required to assume management duties in addition to his former workload; according to Reese, he regularly worked more than 40 hours a week during the course of his employment.

In October 2009, Reese contacted the U.S. Department of Labor, Wage and Hour Division ("DOL") regarding Coastal's failure to provide him with overtime pay. He argued that he was still a non-exempt employee and should be paid for overtime work. In the course of the DOL's investigation, Coastal became aware of the complaint, and it subsequently informed Reese that he would be paid an hourly rate on a going-forward basis. Reese filed suit against Coastal for violation of the Fair Labor Standards Act ("FLSA"), and named SERVPRO as an additional defendant in the case on a joint-employer theory under the FLSA.

The provisions of the FLSA apply only if an entity is actually an employer of an individual, and joint employers can be found jointly and severally liable for damages for failure to comply with the FLSA. In this case, the court applied a four-factor "economic reality test" to determine whether SERVPRO could be considered the joint employer of Reese. The factors considered were the ability of SERVPRO to: 1) hire and fire the employee; 2) supervise and control the employee's work schedule or conditions of employment; 3) determine the rate and method of payment for the hours worked; and 4) maintain employment records of the employee.

*Hiring and Firing.* Pursuant to the terms of the franchise agreement between SERVPRO and Coastal, Coastal was required to conduct background checks on employees and inform SERVPRO of certain results. In practice, Coastal obtained an authorization form from each of its employees, including Reese, that authorized Coastal to conduct the background check and to provide the results to SERVPRO. Reese used this practice to argue that SERVPRO had the power to control hiring and firing of Coastal employees. The court dismissed this argument and instead found that SERVPRO could not be inferred to have the power to hire and fire Coastal employees solely based on its ability to require background checks and to obtain the results. The court found the issue to be one of the "quality control standards SERVPRO requires as a condition to granting a franchise for the use of its system, trade name, service marks, [and] trademarks."

*Control of Schedule and Working Conditions.* Reese also pointed to the terms of the franchise agreement that required Coastal to meet SERVPRO's standards, including with respect to equipment, supplies, uniforms, and computer hardware and software, and he argued that these terms allowed SERVPRO to control the conditions of his employment. To this point, the court found that the requirement of the franchisee to meet system standards does not mean that SERVPRO supervised the franchisee's employees or controlled their working conditions. The court failed to find evidence that SERVPRO had the power to influence daily operations of the business or Reese's work schedule or other conditions of employment.

*Payment and Employee Records.* Finally, Reese noted Coastal's obligations to maintain accounting procedures in accordance with SERVPRO's standards, and to provide accurate records to SERVPRO of gross sales. He claimed these amounted to giving SERVPRO the ability to control what Coastal paid Reese, and he added that SERVPRO maintained employment records for Coastal's employees. The court found that nothing in the franchise agreement empowered SERVPRO to control what Reese was paid. The provisions of the franchise agreement cited by Reese relating to accounting procedures and gross sales simply allow the franchisor to "assess the viability of the franchise," "compute the royalties and fees due to it," and "ensure the future value of its trademark, proprietary system information, and quality associated with the SERVPRO brand name." The court did not find any evidence that SERVPRO had maintained any employee records, or used information maintained to control the daily management of Coastal or its employees.

Also interestingly, the court seemed to give weight to the no third-party beneficiary clause of the franchise agreement, providing that agreement should not be construed to provide any rights to any third party or entity. The court found no evidence of an employment relationship between SERVPRO and Reese, and it granted summary judgment to SERVPRO.

Franchisors and their counsel should carefully consider the test used by the court to ascertain whether a franchisee's employee could also be considered an employee of the franchisor. In this case, the facts led the court to find that no employment relationship existed. However, franchisors should review their franchise agreements and current practices to consider whether they maintain the ability to control, or have actual control, over employees of franchisees in the system.

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# NEWS BRIEFS

## Franchisee Satisfaction Survey Points to Disconnect

The first National Franchisee Satisfaction Survey, released by Franchise Facts in January, paints a bleak picture of franchisee profitability, satisfaction, and franchisor relations, and it concludes that franchisors have a long way to go to improve relations and support of their franchisees.

"Franchisees have had an exceptionally difficult year — possibly the worst of their working lives. National Franchisee Satisfaction Survey respondents report that few are meeting their financial goals, seeing increased revenues/profits or would consider recommending their current franchise to a prospective franchisee. The vast majority [84%] do not expect to be with their current franchise in five years time," the survey states.

The survey, which was three years in the making, attempts to deepen the understanding of franchising from a franchisee's perspective, said Perry Shoom, president of Franchise Facts (www.franchisefactsusa.com). With better information, he believes that franchisors and franchisees can improve relations, operations, and brand success. "What has passed for research in the last few years — in franchising and in other industries — has usually been done by companies to support their marketing claims," he said. "We are taking research back to its roots. This is research that a company can act on."

A sampling of specific findings underlines the depth and breadth of franchisees' concerns:

- 15% of franchisees feel that their franchisors provide good support (pre-opening, opening, and ongoing);
- 18% of franchisees feel that their franchisor is concerned with local store profitability;
- 14% of respondents feel they have a good relationship with their franchisor; and
- 16% of respondents would recommend their current franchise to a prospective franchisee.

Franchisees declared similarly low levels of satisfaction with ongoing training and marketing, the caliber of vendor programs they are offered, and even their franchisor's understanding that "I must be successful for them to be successful."

However, Shoom points out that franchisors should not necessarily expect very high satisfaction ratings across large populations of franchisees. "I don't think it's realistic that any franchise would see 80% franchisee happiness or that 90% of franchisees are satisfied with their financial success," he said. "In dealing with businesses that are diverse, if you could hit 50% satisfaction, that would be good."

Perhaps the biggest takeaway for franchisors, according to Shoom, is the high percentage of franchisees who say that they do not expect to be operating their franchise in five years. "This means that franchisors have a lot of work to do to either keep those franchisees in the system or replace them with new operators," he said.

The 2010 National Franchisee Satisfaction Survey can be accessed for free at www.FranchiseFactsUSA.com/reports.php. The survey will be compiled each year from January through October, and then analyzed and released in the following January. Franchise Facts also conducts private, targeted surveys for franchise clients.

## Clarification of Red Flags Rule Assists Franchisors

On Dec. 18, 2010, the Red Flags Program Clarification Act of 2010 was signed by President Obama and went into effect on Dec. 31, 2010. The Clarification Act clarifies the application of the Red Flags Rule by the Federal Trade Commission ("FTC") by defining more specifically which types of financial transactions will define a business as a "creditor" under the law.

The Red Flags Rule requires businesses and other entities to develop and implement identity theft prevention programs. It was published in November 2007 and went into effect on Aug. 1, 2009, nearly a year later than initially planned because businesses struggled to comply. Further issues arose during the first year of compliance, which the new Act seeks to address.

"The effect of this clarifying act is that professionals and businesses that provide products and services in advance and require payment at a later time are not required to comply with the Red Flags Rule. Franchisors that provide services to franchisees and then bill later for these services would also not fall under the definition of a 'creditor' solely because of that practice," said Meredith Bauer, attorney with Larkin Hoffman Daly & Lindgren Ltd. in Minneapolis.

Previously, the Red Flags Rule had been interpreted so that providing a service in advance of payment would make any business a creditor. But it was pointed out that almost any business transaction — from a franchisor providing services in advance of a royalty payment to an attorney billing on a 30-day cycle — would be defined as a creditor.

However, other activities by franchisors might still leave them subject to the Red Flags Rule — for example, if they provide or arrange for financing for the initial franchise fee or required site upgrades. Bauer said that franchisors that work with small franchisees who sign franchise agreements as individuals and link their personal bank accounts to the franchisor, perhaps for the purpose of regular disbursement of royalties, would likely be covered by the Red Flags Rule. "In addition, language in the new law retains the right of the FTC to find application of the law to a creditor if it determines there is a 'reasonably foreseeable risk' of identity theft," she said.

The FTC's Red Flags Rule Web site is www.ftc.gov/bcp/edu/microsites/redflagsrule/index.shtml, and the new law is a highlighted link.

## Virginia AG Clarifies Definition of Franchising Relationship

In January, Virginia Attorney General Ken Cuccinelli clarified that a

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"typical" franchise relationship would not subject the franchisor to the provisions of a state law that was proposed in 2010 that would have raised penalties on employers who misclassify employees as contractors. Cuccinelli's opinion letter was a response to an official request for an advisory opinion by Del. James LeMunyon regarding whether franchisees would be considered "employees" or "independent contractors" under the Worker Misclassification Act (Senate Bill 34). The bill did not pass in the 2010 legislative session.

States have been cracking down on misclassification of workers by employers seeking to avoid requirements for unemployment insurance, workers' compensation, and other requirements. Senate Bill 34 was Virginia's latest example.

Cuccinelli wrote that franchising is a "distinct form of business enterprise" in which a franchisee is not an employee of the franchisor. "The franchisee is not performing services 'for an employer,'" Cuccinelli wrote. "Rather, the franchisee, upon reaching agreement with the franchisor, is performing services for the profit and account of the franchisee. In addition, unlike the ordinary contract of employment, the franchisee is not being remunerated by the franchisor. Instead, it is the franchisee who pays the franchisor for the privilege of using a trademark and business system. I also note that the typical franchisee is not an 'individual' but a corporation. Consequently, application of this test to typical franchise agreements would result in the exclusion of franchisees and franchisors from the scope of this statute."

The opinion can be found at www.vaag.com/OPINIONS/2011opns/10-111-LeMunyon.pdf.

### NJ Proposes to Expand Layoff Warnings to Multi-Unit Operators

The New Jersey legislature is considering a bill that would extend the state's laws requiring employers to notify employees prior to a layoff to multi-unit franchise systems. As Assembly Bill 3583, the bill passed a vote in the Labor Committee on Jan. 25 and was moved as the identical Senate Bill 2679 to the Senate Labor Committee.

Mark Diana, attorney with employment and labor law firm Ogletree Deakins (Morristown, NJ), said that the law would have a significant effect on multi-unit franchisors and franchisees in New Jersey. "Specifically, the new definition of 'employer' would include 'a holding company or franchisor which operates one or more franchise locations, and all of the franchise location owners or franchisees of the franchisor,'" he wrote in a short analysis of the bill. "Second, the bill would expand the definition of an 'establishment' to include 'one or more franchise locations of a franchisor.' Third, the bill defines 'franchise location' as 'an establishment operated by a franchisee of a common franchisor, which establishment may share a common name or business model with one or more other franchise locations of a common franchisor.'"

With those expanded definitions, franchisors and multi-unit franchisees would have to count proposed terminations and layoffs that would occur within a 30-day period at all potentially affected units in New Jersey as a single unit, and then determine if that reached the threshold for the state's definition of a "mass layoff," thus triggering notification requirements.

The bill can be found by searching at www.njleg.state.nj.us/bills/billsbynumber.asp.

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## *ABA Conference*

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at the Federal Reserve, will reshape the marketplace for consumer financial products and services.

Earlier in the day, FTC Commissioner J. Thomas Rosch had taken the position that the CFPB is completely unnecessary — but his panel had a different job: to give a bird's-eye view of consumer protection enforcement priorities and policy initiatives. Commissioner Rosch harkened back to his days in the mid-70s as director of the Bureau of Consumer Protection to identify what has changed most. He singled out online shopping for blurring the distinction between "advertising" and "selling" — with substantial implications not only for consumer protection enforcement, but also for resale price maintenance or vertical price fixing.

### Canada

Not surprisingly, privacy was at the top of the list for Jennifer Stoddart, Privacy Commissioner of Canada. She summarized the consumer protection mission and activities of her office and spotlighted its investigations of Google and Facebook. She observed that more investigations are targeting companies with little or no presence in Canada, and she delivered a pointed message that Google and Facebook were "symptomatic of the failure of U.S. companies to consider local law outside of the U.S."

### Consumer Protection Priorities

For the Department of Justice, the consumer protection priorities are health care fraud, mortgage fraud, food safety, and false advertising. Assistant Attorney General Tony West, who heads the 1,000-lawyer Civil Division, claimed more than $10 billion in fraud settlements, fines, and penalties since January 2009 and promised to continue the momentum.

As a species of consumer protection, franchising regulation can be expected to be infused by trends in the larger policy sphere. The policy makers at GWU in February sent plenty of smoke signals.

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