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Andrew Loewinger - *Nixon Peabody,* Will Woods - *DLA Piper*

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2009 HOSPITALITY LAW CONFERENCE

Hot Topics in Franchising and Hospitality

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Presenters

- Andrew Loewinger, partner in the Washington, D.C. office of Nixon Peabody LLP
- Co-chair of the firm's Franchise and Distribution Practice Group
- Andrew is a frequent speaker before American Bar Association Forum on Franchising, International Bar Association, and the International Franchise Association on franchise-related matters.
- Andrew is an internationally recognized franchise lawyer

- Will Woods, partner in the Dallas office of DLA Piper LLP (US).
- He concentrates his practice primarily in franchise and distribution law.
- Mr. Woods represents franchisors throughout their business life cycle: in the start-up stage; as middle-market franchisors; and as mature, global franchisors.
- Mr. Woods also has significant experience in negotiating complex franchise transactions and counseling clients with respect to system re-structuring and related relationship issues.

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2009 HOSPITALITY LAW CONFERENCE

HOT TOPICS IN FRANCHISING AND HOSPITALITY

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February 9-11, 2009
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Andrew Loewinger is a partner in the Washington, D.C. office of Nixon Peabody LLP (an international law firm of 700 attorneys with national offices throughout the United States, and in London, Paris, and Shanghai) where he is co-chair of the firm's Franchise and Distribution Practice Group. Andrew is an internationally recognized franchise lawyer, and has represented numerous U.S. and non-U.S. companies in franchising and distribution matters in the United States and internationally on international franchising, licensing and distribution matters; franchise mergers and acquisitions; structuring and development of franchise programs; joint ventures; intellectual property licensing and protection; franchise sales law compliance; franchise relationship matters; franchisee association matters; and counseling on franchise disputes. He has devoted his practice full-time to franchising since 1985.

Andrew is a frequent speaker before American Bar Association Forum on Franchising, International Bar Association, and the International Franchise Association on franchise-related matters, and is the author of numerous articles for those organizations and others on franchise matters.

He is the co-editor and co-author of *International Franchise Sales Laws* published by the American Bar Association in 2006. Andrew was appointed in 2004 as the first Director of the International Franchise and Distribution Division of the American Bar Association's Forum on Franchising.

He has been recognized for several years as one of the top franchise lawyers in the United States and internationally in *Who's Who Legal, The International Who's Who of Business Franchise Lawyers;* as one of the top franchise lawyers in the United States in *Chambers USA: America's Leading Lawyers for Business* and internationally in *Chambers Global;* as one of the best lawyers in America in *Best Lawyers in America* in franchise law; and in *Franchise Times'* "Legal Eagles" as one of the top franchise lawyers in the United States and Canada.

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Mr. Woods is a frequent author and speaker on franchise and distribution related topics. His publications include *Good News on State Taxation of Out-of-State Franchisors in New Mexico . . . Or Not*, Franchise Law Journal (Winter 2007), *State of the States: Highlights of Franchise Legislative Activity in 2001*, The Franchise UPDATE Supplier and Resource Guide (May 2002), *Item 19 Earnings Claims: A Disclosure Most Franchisors Should Try to Make*, Franchise Law Journal (Spring 2001) and *State of the States: Highlights of Franchise Legislative Activity in 2000*, The Franchise UPDATE Supplier and Resource Guide (March 2001).

Mr. Woods is an active member of various trade and bar associations, including the International Franchise Association and the ABA Forum on Franchising. In 2007, he was named a Rising Star by *Texas Monthly Magazine.*

He was the ABA Young Lawyers Division Liaison to the ABA Forum on Franchising from 2005 to 2007.

Mr. Woods received his BBA from Baylor University in 1994 and his JD, *cum laude*, from Baylor University School of Law in 1998, where he served as Lead Articles Editor for the *Baylor Law Review*. He is a member of the Texas Bar.

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There have been a variety of developments in franchising in the past year. We survey below developments in two areas – liquidated damages and international franchising – and address the most topical issue now facing many hospitality franchisors – dealing with franchisees in a difficult economy.

I. LIQUIDATED DAMAGES

Liquidated damages provisions have been a fixture in hotel franchise agreements and are becoming increasingly popular in restaurant and other franchise systems. The principal driving force behind these provisions is the difficulty (and uncertainty) in collecting lost future royalties from a franchisee who is terminated by a franchisor based on a material default of the franchise agreement. The case law regarding lost future royalties (where there is no liquidated damages provision) is unsettled and varies from state to state.[1]

Liquidated damages provisions have made it easier for franchisors to recover damages for future lost royalties by reducing those damages, which are inherently speculative, to a distinct and easy to calculate amount, which is typically based on a projected level of lost future royalties for a specific time period based on the franchisee's past royalty payments.[2] As a result of the parties having agreed to a specific calculation of damages at the outset of the relationship, courts have readily enforced liquidated damages provisions. Generally, a provision will be enforced if it is a reasonable forecast of the harm that will result from a breach. A liquidated damages clause will not be enforced if the court finds that it does not bear a reasonable relationship to the range of actual damages that the parties could have anticipated to flow from the breach, and therefore imposes a penalty.[3]

Because liquidated damages provisions are generally favored by courts, the party opposing enforcement (*i.e.*, the franchisee) has the burden of showing that the provision is unreasonable. In determining the reasonableness of a liquidated damages clause, courts will look at "the totality of the circumstances," including (a) conditions at the time of contract formation and at the time of the breach; (b) the difficulty in assessing actual damages; (c) the intention of the parties; (d) the actual damages sustained; and (d) the relative bargaining power of the parties.[4]

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* The authors would like to thank Christopher Wallace of Nixon Peabody LLP for assisting in the preparation of several portions of this paper.

[1] *See Postal Instant Press, Inc. v. Sealy*, 43 Cal. App. 4th 1704 (1996), and its progeny.

[2] In addition to royalties, these calculations often include advertising fees and other recurring fees.

[3] *See Ganesh, Inc. v. Days Inns Worldwide, Inc.*, Bus. Franchise Guide (CCH) ¶ 12,341 (N.D. Ohio Mar. 21, 2002); *Encore Hotel Owners II, LLC v. Red Roof Inns, Inc.*, Bus. Franchise Guide (CCH) ¶ 12,734 (S.D. Ind. Dec. 9, 2003).

[4] *See, e.g., Radisson Hotels Int'l, Inc. v. Majestic Towers, Inc.*, Bus. Franchise Guide (CCH) ¶ 13,680 (C.D. Cal. Jan. 25, 2007); *La Quinta Franchising, LLC v. Kettleman City Commercial, LLC*, No. 1:07-cv-01230, 2008 WL 2073967 (E.D. Cal. May 14, 2008); *Encore*, Bus. Franchise Guide (CCH) ¶ 12,734; *Ganesh*, Bus. Franchise Guide (CCH) ¶ 12,341; *Days Inn Worldwide, Inc. v. BFC Mgmt., Inc.*, 544 F. Supp. 2d 401, 406 (D.N.J. 2008).

The majority of cases regarding the enforceability of liquidated damages provisions in franchise agreements have involved hotel franchises. The past year was no exception. Below is a brief discussion of the noteworthy cases that were decided in 2007 and 2008.

A. *Country Inns & Suites by Carlson, Inc. v. Nayan, LLC,* 2008 U.S. Dist. LEXIS 88559 (S.D. Ind. Oct. 28, 2008). In this case, the franchisee was terminated by Country Inns for failing to timely pay amounts owed under the franchise agreement. After being terminated, the franchisee continued to use the Country Inns marks and other items associated with the Country Inns System. The franchise agreement contained a liquidated damages clause that stated "the actual damages that Country [Inns] would suffer for the loss of prospective fees and other amounts payable to Country [Inns] under Article 5 would be difficult if not impossible to ascertain."[5]

Country Inns sued the franchisee for payment under the liquidated damages clause and for an injunction to enjoin the franchisee from using its trademarks. In objecting to the injunction, the franchisee argued that the liquidated damages clause precluded Country Inns from establishing that it had no adequate remedy at law, a required element of an injunction, because it set forth a specific amount of damages in the event of termination. However, the court disagreed because the language of the liquidated damages clause made it clear that it was an estimation of the actual damages that Country Inns would suffer "for the loss of prospective fees and other amounts payable to Country [Inns]."[6] Accordingly, because the liquidated damages clause did not address harm to Country Inns' goodwill and reputation, it did not preclude the court from granting an injunction based on trademark infringement.

B. *Country Inns & Suites by Carlson, Inc. v. Interstate Properties, LLC,* 2008 U.S. Dist. LEXIS 54265 (M.D. Fla. July 16, 2008). In another case involving Country Inns, a franchisee transferred its hotel to a third party despite the third party's refusal to enter into a new franchise agreement with Country Inns. Country Inns terminated the franchisee and sought to enforce the liquidated damages provision, which used a formula based on three years of royalties and advertising fees. The court upheld the provision under Florida law on the ground that it was not "grossly disproportionate to any damages that might reasonably be expected to follow from the breach."[7] The Court also rejected the franchisee's argument that the liquidated damages amount should be reduced to its present value because that calculation could have been written into the contact but was not.

C. *La Quinta Corp. v. Heartland Properties, LLC,* 2008 U.S. Dist. LEXIS 53297 (W.D. Ky. July 14, 2008). In this case, the franchisee was terminated after refusing to enter into a mandatory software license agreement. La Quinta sought to enforce its post-term remedies,

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5 *Country Inns & Suites by Carlson, Inc. v. Nayan, LLC*, 2008 U.S. Dist. LEXIS 88559 at *21-22 (S.D. Ind. Oct. 28, 2008).

6 *Id.*

7 *Country Inns & Suites by Carlson, Inc. v. Intestate Properties, LLC*, 2008 U.S. Dist. LEXIS 54265 at *12 (M.D. Fla. July 16, 2008), citing *Travelodge Hotels, Inc. v. Kim Shin Hospitality, Inc.*, 27 F. Supp. 2d 1377, 1383 (finding a formula based on five years' worth of franchise payments reasonable considering unexpired term of 18 years).

including liquidated damages calculated as the sum of all recurring fees over the prior three years (approximately $111,000).[8] The court enforced this damages calculation under Wisconsin law as reasonable. In addition, the court awarded La Quinta treble damages for the franchisee's willful and unauthorized use of La Quinta's intellectual property after the franchise agreement was terminated.[9] Those damages were in addition to the liquidated damages provided for under the agreement.

D. *Days Inn Worldwide, Inc. v. BFC Management, Inc.*, 544 F. Supp.2d 401 (D.N.J. 2008). This is another case where the court, applying New Jersey law, awarded the franchisor treble damages for willful trademark infringement in addition to liquidated damages. Here, the liquidated damages provision provided for the greater of (i) all recurring fees over the prior two years, or (ii) $2,000 per room (which, in this case, totaled $204,000). The court upheld this liquidated damages amount on the grounds that the parties were of comparable bargaining power, the parties intended for Days Inn to receive a minimum of $204,000 upon the franchisee's breach, actual damages were very difficult to assess, and the amount was reasonable in light of the actual damages sustained.[10]

E. *Radisson Hotels International, Inc. v. Majestic Tower, Inc.*, 488 F. Supp. 2d 953 (C.D. Cal. 2007). A Radisson franchisee was in business less than one year when he fell behind in payments and was terminated. The franchise agreement provided for liquidated damages of two times the amount payable to Radisson for the immediately preceding 12 months. The court upheld this amount (approximately $668,000) under California law because the franchisee failed to prove that the amount or time period was unreasonable.[11]

Notably, the court upheld the 12 month period for calculating damages even though the franchisee had operated the hotel for less than 12 months. Radisson was permitted to include the revenue generated by the prior owner because the liquidated damages clause entitled Radisson to recover double the amount of royalties that were "payable" to Radisson during the preceding 12 months. The clause did not state that the "payable" amounts must be limited to the defendant's time as a franchisee.[12]

F. *Ramada Worldwide, Inc. v. Homewood Hotel, Inc.*, 2007 U.S. Dist. LEXIS 8338 (N.D. Ill. Feb. 5, 2007). The liquidated damages clause at issue in this case provided for damages of $150,000. The court awarded this amount to Ramada (in addition to treble damages for the franchisee's willful trademark infringement) based in large part on the fact that the franchisee's attorney successfully negotiated a lower liquidated damages amount in the contract

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8 *La Quinta Corp. v. Heartland Properties, LLC*, 2008 U.S. Dist. LEXIS 53297 at * 4 (W.D. Ky. July 14, 2008).

9 *Id.* at *7.

10 *Days Inn Worldwide, Inc. v. BFC Management, Inc.*, 544 F. Supp.2d 401, 406-407 (D.N.J. 2008).

11 *Radisson Hotels International, Inc. v. Majestic Tower, Inc.*, 488 F. Supp. 2d 953, 959-960 (C.D. Cal. 2007).

12 *Id.* at 961.

before it was signed. This fact negated any argument of unequal bargaining power or unreasonableness.[13]

G. *La Quinta Franchising, LLC v. Kettleman City Commercial, LLC,* 2008 U.S. Dist. LEXIS 39139 (E.D. Cal. May 14, 2008). In this case, applying Texas law, the court granted La Quinta a default judgment that included the full amount of liquidated damages ($100,000), prejudgment interest on the liquidated damages, costs, and attorneys' fees. The court held that liquidated damages were enforceable in default judgments and that the franchisee did not have a right to a further evidentiary hearing.[14]

H. *Super 8 Motels, Inc. v. Kumar,* C.A. No. 06-5231, 2008 U.S. Dist. LEXIS 28066 (D.N.J. Apr. 1, 2008). This is another case where liquidated damages were upheld in a default judgment. The calculation of liquidated damages was $2,000 multiplied by the number of guest rooms that the franchisee was authorized to operate (for a total of $68,000). Applying New Jersey law, the Court awarded Super 8 liquidated damages, prejudgment interest on the liquidated damages, and attorneys' fees and costs.[15]

II. INTERNATIONAL DEVELOPMENTS

A. Australia

Franchising in Australia is governed by the Trade Practices (Industry Codes – Franchising) Regulations 1998 and is known as the Franchising Code of Conduct (the "Code"), which went into effect on July 1, 1998. The Code requires that a franchisor provide a copy of the franchisor's disclosure document to: (1) a prospective franchisee at least fourteen days before the prospective franchisee (a) enters into a franchise agreement or an agreement to enter into a franchise agreement, or (b) makes a nonrefundable payment (whether of money or of other valuable consideration) to the franchisor or an associate of the franchisor in connection with the proposed franchise agreement; and (2) a franchisee at least fourteen days before renewal or extension of the franchise agreement. There is also a "cooling off" period of seven days which gives a franchisee the opportunity to terminate the franchise agreement within seven days of signing it. The franchisor is also required to obtain a certificate from a prospective franchisee that the franchisee has received, read, and had a reasonable opportunity to understand the Code and the franchisor's disclosure document. There are no governmental filing, registration or approval requirements under the Code that must be satisfied prior to or after providing a disclosure document or franchise agreement to a franchisee.

In 2007, the Australian Federal Government enacted certain changes to the Code, which became effective on March 1, 2008. Some of the key changes included:

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[13] *Ramada Worldwide, Inc. v. Homewood Hotel, Inc.*, 2007 U.S. Dist. LEXIS 8338 at *19-20 (N.D. Ill. Feb. 5, 2007).

[14] *La Quinta Franchising, LLC v. Kettleman City Commercial, LLC*, 2008 U.S. Dist. LEXIS 39139 at *12-15 (E.D. Cal. May 14, 2008).

[15] *Super 8 Motels, Inc. v. Kumar*, C.A. No. 06-5231, 2008 U.S. Dist. LEXIS 28066 at *14-17 (D.N.J. Apr. 1, 2008).

· The exemption for foreign franchisors who grant only one franchise or master franchise in Australia was removed;

· Franchisors must audit their marketing funds unless at least 75% of their Australian franchisees agree that it is not necessary;

· Franchisors must provide financial disclosure for the consolidated entity to which it belongs, upon the request of a franchisee;

· Disclosure is required when the “scope or term” of a franchise agreement is to be extended (therefore applying to more than just renewals);

· A copy of the franchise agreement “to be executed” must be attached to the disclosure document, not just the intended form;

· Details of franchisees who have left the system is limited to the previous three years and only if the information is available and the former franchisee has not requested that their information be kept confidential; and

· The franchise agreement cannot include waivers or disclaimers of past representations.

A 2007 case highlighted the importance of strict compliance with the disclosure requirements under the Code. In *Ketchell v. Master of Education Services Pty Ltd 2007*, NSWCA 161, the Supreme Court of New South Wales Court of Appeal ruled that a franchisor’s failure to obtain the certificate of receipt from a prospective franchisee, as required by the Code, rendered the subsequent franchise agreement void. The case was subsequently reversed on appeal.

B. Belgium

Effective February 1, 2006, Belgium adopted a new disclosure law that applies to “agreements of commercial partnership” in which one party concedes to the other party, in return for a fee, a “commercial formula” to be used in connection with the sale of products or the provision of services. The commercial formula must include one or more of the following: (1) a common brand; (2) a common commercial name; (3) the transfer of know-how; or (4) the provision of commercial or technical assistance. The law is not limited to franchise agreements.

Franchisors are required to make formal pre-contractual disclosure to prospective franchisees one month before the franchise agreement is signed or consideration is paid to the franchisor. Failure to do so renders the franchise agreement unenforceable. The disclosure document is divided into two sections, with the first section summarizing the main terms of the franchise agreement, and the second section disclosing information relating to the franchisor and the franchise system. If a franchisor fails to comply with the disclosure requirements, the franchisee may rescind the franchise agreement within two years of the date of the agreement. If the disclosure document fails to properly summarize the terms of the franchise agreement, those terms will be null and void.

The law contains no requirement that a governmental filing, registration or approval by any government agency be made or obtained prior to or after providing a disclosure document to a prospective franchisee or prior to or after executing a franchise agreement with a franchisee.

C. Canada

Currently, four provinces in Canada have franchise-specific legislation. Alberta enacted the Franchise Act in 1972, which was substantially amended in 1995, while Ontario introduced the Arthur Wishart (Franchise Disclosure) Act in 2000. The most recent developments have been in Prince Edward Island and New Brunswick, which have enacted legislation that closely follow both the Wishart Act and the model Uniform Franchises Act ("UFA"), which was adopted by the Uniform Law Conference of Canada in 2004.

PEI passed its Franchises Act on June 7, 2005, which became effective on January 1, 2007. Under the Act, a prospective franchisee must receive a disclosure document at least 14 days prior to signing a franchise agreement or any other agreement or paying any consideration to the franchisor. The PEI Franchises Act is applicable to any business that is to be operated partly or wholly in Prince Edward Island under a franchise agreement, including the renewal or extension of a franchise agreement. The PEI Franchises Act contains no requirement that a governmental filing, registration or approval by any government agency be made or obtained prior to or after providing a disclosure document to a prospective franchisee or prior to or after executing a franchise agreement with a franchisee.

The New Brunswick Franchises Act is another disclosure and relationship law that substantially mirrors the Ontario law and the UFA. The New Brunswick Act became law on June 26, 2007 and is expected to become effective upon the promulgation of implementing regulations. The Act requires franchisors to provide a disclosure document to prospective franchisees at least 14 days before the earlier of the execution of an agreement or the payment of any consideration. The New Brunswick Act also guarantees franchisees the right to associate and a right of rescission.

The PEI and New Brunswick Acts, like Ontario's, contain exemptions for agreements relating to employment, partnerships, cooperative associations, certification and single trademark licenses. The PEI and New Brunswick Acts also exempt arrangements arising from an agreement for the purchase and sale of a reasonable amount of goods at a reasonable wholesale price or for the purchase of a reasonable amount of services at a reasonable price. Although the Ontario law requires that a franchise disclosure document be in the format required under the Ontario law, like Alberta, the PEI and New Brunswick Acts do not specifically prescribe a format for the disclosure document, but they do provide a list of minimum information that must be provided and require that all "material facts" be disclosed.

D. China

In June 2004, the Measures for the Administration on Foreign Investment in Commercial Fields ("2004 Commercial Measures") became effective in China to permit foreign investors to establish foreign-invested enterprises in China that could conduct franchise activities. Subsequently, in February 2005, the Ministry of Commerce implemented the Management Measures on Franchise ("2005 Franchise Measures"), which permitted both foreign and domestic franchising in China. Article 4 of the 2005 Franchise Measures permits two basic forms of franchise operations: (a) a "direct franchise"; and (b) a "sub-franchise" or "master franchise." The 2005 Franchise Measures, however, require that franchisors operate at least two directly-owned units for at least one year in China before selling franchises. A franchisor is also required to be an enterprise or other economic organization, which must register at the business registration and administration authority in its locality and obtain its business license from such office.

In January 2007, the State Council issued the Commercial Franchise Administration Regulation ("2007 Regulations"), which regulates all commercial franchise activity in China. The Ministry of Commerce also issued, effective May 1, 2007, the "Administration Rules on Commercial Franchise Information Disclosure" and the "Administration Rules on Commercial Franchise Filing," which regulate franchise disclosure and registration filings, respectively.

The 2007 Regulations define "franchise" broadly and do not provide any exemptions or exclusions from the definition of franchise. The 2007 Regulations, along with the disclosure and filing rules, expressly contemplate cross-border franchising. Although they retain the requirement that a franchisor operate at least two units for at least one year, the Ministry of Commerce has indicated that non-Chinese units may be used to satisfy this requirement.

Under the 2007 Regulations, franchisors must provide prospective franchisees pre-sale disclosure at least thirty days before execution of the franchise agreement. In addition, within fifteen days of the first franchise agreement being signed, a franchisor must file certain documents with either the Bureau of Commerce (if the franchise activities will be at the provincial level) or with the Ministry of Commerce (if the franchise activities will be in more than one province). The documents that must be filed include: a copy of the incorporation certificate or business license; the form of franchise agreement; the franchise operations manual; a marketing plan; a commitment to meet the requirements of Article 7 and supporting evidence (this includes an attestation that the franchisor is able to provide the services and training promised and has operated at least two directly-owned units for at least one year); and product or service approval documents, if applicable.

The 2007 Regulations also contain provisions relating to the franchise relationship, including mandatory franchise agreement provisions, obligations of franchisors to franchisees, and, to a lesser extent, obligations of franchisees to franchisors. Among other things, the Regulations require a minimum term of three years for all franchise agreements (unless the franchisee agrees to a shorter term), and a franchisee must be given a period of time after signing the franchise agreement within which he can unilaterally terminate the agreement.

E. Indonesia

Franchising in Indonesia was originally governed by Government Regulation No. 16 (the "Franchise Law"), which became effective in December 1997. Implementing regulations were issued in July 1997 in the form of the Decree of the Minister of Trade and Industry No. 259/MPP/Kep/7/1997. The Franchise Law required franchisors to give franchisees a disclosure document that included information about the franchisor and its business, the obligations of the franchisee, details of the technical assistance to be provided to the franchisee, the intellectual property rights to be granted to the franchisee, and details regarding termination, cancellation, and extension of the franchise agreement. The disclosure document was required to be given to a prospective franchisee "prior to drawing up an agreement." There was no specified waiting period after disclosure was given before the franchise agreement could be signed. The Franchise Law also imposed the burden on the *franchisee* to register the executed franchise agreement with the Department of Trade and Industry within 30 days of the effective date of the agreement.

In July 2007, the Franchise Law was revoked and replaced by Government Regulation No. 42 (the "New Franchise Regulation"). The New Franchise Regulation retained much of the original Franchise Law, as described above, but added several new requirements. Significantly, it changed the definition of "franchise," introduced a registration requirement for franchisors, added additional disclosure requirements, and introduced administrative sanctions.

Under the New Franchise Regulation, the disclosure document must be provided to a prospective franchisee at the time of the offer, although it does not define exactly what constitutes an "offer." Also, the franchisor must register the disclosure document with the Department of Trade prior to executing the franchise agreement. The franchisee is still required, as it was under the Franchise Law, to file the executed franchise agreement, but under the New Franchise Regulation, the franchisee must also file a copy of the franchisor's business licenses, a copy of the disclosure document, and a copy of the identity card of the owner/management of the franchisee.

F. South Korea

In November 2002, South Korea enacted the South Korean Act on Fairness in Franchise Transactions (the "Act"). The Act requires that a franchisor provide a disclosure document to a prospective franchisee at least five days prior to the execution of an agreement or payment of a fee. A Presidential Decree to implement the Act on Fairness in Franchise Transactions, which was amended in 2003, provides specific details regarding fees, terminations, disclosures, and many other matters provided for in the Act. No filing requirements were applicable to the disclosure document or a franchise agreement under the original Act.

On August 3, 2007, the Act was amended to add a significant new registration requirement, additional disclosure requirements, an unusual escrow requirement and "cooling off" period that applies to all franchisors, additional franchisee territorial protections, and a "just cause" requirement for non-renewal and termination. These amendments were to become effective on February 4, 2008, but the Korean Fair Trade Commission (the "Commission") postponed the effectiveness of the disclosure and registration requirements until August 5, 2008.

Under the Act, as amended, franchisors in South Korea must register a detailed disclosure document with the Commission and deliver the disclosure document to prospective franchisees. If the disclosure document contains false or misleading information or omits material information, the franchisee has the right to rescind the franchise agreement and demand a refund of the franchise fees paid. The Act also requires a franchisor to observe a fourteen day "cooling off" period after delivering the disclosure document, during which time it cannot accept any payments from, or sign any agreements with, the prospective franchisee.

G. Vietnam

Vietnam adopted its franchise regulations in 2005 as part of its Commercial Law, which were elaborated on in Decree No. 35/2006/ND-CP and Circular No. 09/2006/TT-BTM, both of which were promulgated in 2006. The franchise regulations require both pre-sale registration and disclosure with some franchise relationship provisions.

Before a franchisor can begin franchising in Vietnam, the business system to be franchised must have been operating somewhere (either within or outside Vietnam) for at least one year. Similarly, a master franchisee cannot grant subfranchises until it has operated the franchised business for at least one year. Once this experience threshold is met, a foreign franchisor must register its "franchising activities" (which is typically read to mean the sale of franchises) with the Ministry of Trade while a domestic franchisor must register with the Department of Trade.

Franchisors must provide a disclosure document to prospective franchisees at least fifteen working days prior to the execution of a franchise agreement, "unless the parties otherwise agree." Thus, the parties could agree to a shorter cooling off period. The disclosure document must include specific subject matters which are outlined in detail in the franchise regulations.

III. DEALING WITH FRANCHISEES IN A DIFFICULT ECONOMY

The United States economy is currently in what many economists are predicting will be the deepest recession since the downturn of the early 1980s, and the prospect of a significant recession in the hotel industry is virtually certain. High food, fuel, and commodity prices; frozen credit markets; deflation of asset values; and a pullback in consumer and business spending and travel, the likes of which have not been experienced in many years, all contribute to the woes of hotel franchisees. Given the extremely challenging economic climate and the impact that it is having, and will have, on occupancy and overall profitability of hotels, it is critical for hotel franchisors to plan now for dealing with distressed franchisees. This section does not discuss the intricacies of formal workouts and bankruptcies but, instead, examines problems that are likely to arise with franchised hotels during difficult economic times as well as practical strategies to address those problems.

A. Typical problems arising in hotel franchise relationships during an economic downturn

Although defaults and other issues under hotel franchise agreements, like the examples discussed below, can and do arise even in the best of times, the likelihood that a greater proportion of franchisees will experience difficulties and ultimately violate the terms of their franchise agreements is greater during times of economic distress. Franchisors must be attuned to potential defaults (particularly those that can have a lasting negative impact on the brand) and warning signs and proactively monitor their franchisees' financial condition and operations so that they can be in a better position to deal with problems as they arise. Of course, it is oftentimes the case that, the earlier problems are identified, the more likely a viable solution can be devised to resolve the issue and minimize acrimony between the franchisor and franchisee.

1. Failure to timely convert/open for business

Hotel franchise agreements generally contain provisions that require the franchisee to complete construction (in the case of a new build property) or conversion and other renovation requirements (in the case of a conversion property) within a certain period of time after the franchise agreement is executed. Given the current difficulty of obtaining financing (even for well-qualified borrowers) and the general market uncertainty, more franchisees may be in a position where they cannot meet opening deadlines or they simply delay moving projects forward until some certainty returns to the markets. Franchisors should have systems in place to monitor construction/conversion work progress and interim deadlines and engage in open dialogue with franchisees that are not making adequate progress.

2. Property improvement and upgrade issues

In the highly competitive hotel market of recent years, many hotel companies have enhanced brand standards and have required that their franchisees made significant upgrades to both guest rooms and common areas of their hotels, either as part of a regular property improvement plan (PIP) cycle or in connection with special system-wide initiatives. These upgrades range from requiring the use of higher-end bathroom amenities to replacing standard cathode ray television sets with flat screen, high definition sets to re-vamping lobbies, restaurants, and other common areas.

Although hotel companies have legitimate operational and competitive reasons to require property improvements and upgrades, these types of upgrades often come at significant up-front, and sometimes ongoing, cost to franchisees. As with the initial conversion/construction work, franchisees may have difficulty obtaining appropriate financing for upgrades, particularly those that involve significant capital expenditures, and franchisors should, as discussed below, carefully consider which upgrades make sense to require in the current environment and address situations in which franchisees are not meeting those requirements.

3. Standards violations

In light of falling occupancy and overall profitability, franchisees may be tempted to postpone regular maintenance work or otherwise cease complying with system standards. Maintaining the property and meeting operational standards is, obviously, a core obligation of the franchisee and any failure to comply with standards should be taken very seriously since failure to comply with standards can have a lasting effect on the property and the brand as a whole.

Further, noncompliance with standards could signal deeper problems with a particular franchisee, such as mismanagement or financial difficulties. Franchisors should monitor compliance with standards through periodic quality assurance evaluations and property inspections. Additionally, complaints from hotel guests and declining grades on guest response surveys should be investigated.

4. Payment defaults

Failure to pay amounts due under the franchise agreement such as royalties, advertising fees, reservation system fees, and other amounts is the most obvious indication that a franchisee may be in distress. While delays in payment are not uncommon, a systematic failure to pay (or pay on time) could indicate trouble. Franchisors must monitor payment patterns and deal with payment issues quickly. Additionally, franchisors should enforce the financial reporting requirements of the franchise agreement and analyze the information and trends in those reports in an effort to identify potential problems early.

B. What can/should a franchisor do to prepare for and deal with issues when they arise?

Franchisors should proactively plan for addressing franchisee defaults in a manner that is fair to franchisees and protects the brand—not simply respond when problems arise. Discussed below are several strategies for anticipating and dealing with franchisee defaults as well as issues that franchisors must consider when implementing any plan for addressing defaults.

As a general matter, franchisors must always consider the effect of any plan for addressing defaults with any particular franchisee on the system as a whole and on other individual franchisees. "Going light" on one franchisee without a demonstrable business justification while strictly enforcing the terms of the franchise agreement on other franchisees with respect to the same or similar defaults can create resentment within the franchisee community or could be a violation of applicable anti-discrimination laws as discussed below, and, ultimately, can harm the brand as a whole.

1. Understand the franchisor's rights/remedies.

A critical first step in addressing defaults under a franchise agreement is to analyze what the franchisor's rights and remedies are under the franchise agreement and applicable law. A failure to act in accordance with the franchisor's contractual rights and the law can result in exposure to liability such as breach of contract claims and actions by franchisees and regulators under applicable statutes.

a. Under the contract

Courts are generally willing to enforce a franchisor's right to take action against franchisees (including terminating franchisees) if the franchise agreement clearly gives the franchisor the right to take such action and the facts support the franchisor's action.[16] However,

[16] *See, e.g.*, International House of Pancakes, Inc. v. McNeil, 2007 U.S. App. LEXIS 4840 (4th Cir. Mar. 2, 2007) (The court granted IHOP summary judgment on its breach of contract claim, holding that a failure of the franchisee to maintain sales records for 36 months as required by the franchise agreement was an appropriate basis for termination.), Maple Shade Motor Corp. v. Kia Motors America, Inc., 260 Fed.Appx. 517 (3rd Cir.

franchisors must understand what the franchise agreement says and proceed cautiously before taking action. A failure to do so could result in a breach of contract or wrongful termination claim.[17]

b. Franchise relationship laws

Approximately twenty states[18] have franchise relationship laws which generally require that franchisors comply with substantive and procedural requirements with respect to certain aspects of their relationships with franchisees, including termination, nonrenewal, and transfers. For example, the California Franchise Relations Act provides that the franchisor must have "good cause" in order to terminate a franchisee and that the franchisor must give the franchisee written notice and a "reasonable opportunity" to cure most defaults prior to terminating.[19] Franchisors must, therefore, determine whether there are any applicable franchise relationship laws and comply with those laws, regardless of what the franchise agreement provides, before issuing any warning, default or termination notices to franchisees.

Additionally, sixteen states'[20] franchise relationship laws contain some form of anti-discrimination provision. Generally, those provisions prohibit a franchisor from discriminating "unfairly" in its dealings with franchisees.[21] Most of these provisions specifically permit a franchisor to treat its franchisees differently, provided there is some reasonable basis for doing so (e.g., the franchise is granted at a different time, the concept is in development or is experimental, or there are other reasonable distinctions and the disparate treatment is not

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2008) (The court held that Kia had good cause for terminating the franchise agreement in connection with Maple Shade's failure to build a separate showroom for Kia's vehicles as agreed-upon under the franchise agreement.), Shaffer v. Domino's Pizza, Inc., 2006 WL 355022 (E.D.N.Y. 2006) (Domino's properly terminated the franchise agreements in connection Shaffer's failure to maintain liability insurance.), *but see,* Magna Cum Latte, Inc. v. Diedrich Coffee, Inc., 2007 Bankr. LEXIS 4265 (Bankr. S.D. Tex. Dec. 17, 2007) (holding that the franchisor's termination of the franchise agreement due to the fact that the head lease, which was held by the franchisor, was not renewed was improper and that the failure of the franchisor to renew the lease was a breach of the implied duty of good faith and fair dealing under California law, even though the franchise agreement expressly permitted termination in that event and the franchisor had no express obligation to renew the lease).

17 *See, e.g.,* Voice-Tel Enterprises, Inc. v. JOBA, Inc., 258 F. Supp.2d 1353 (N.D. Ga. 2003) (The court held that franchisees did not materially impair franchisor's trademark, within meaning of provision authorizing termination of franchise agreement.) and LaGuardia Associates and Field Hotel Associates v. Holiday Hospitality Franchising, Inc., 92 F.Supp.2d 119 (E.D.N.Y. 2000) (Since franchisor had repeatedly waived past payments defaults, franchisor could not terminate the franchisee agreement for franchisee's failure to comply immediately and strictly with payment terms without first providing sufficient notice and a reasonable time for franchisees to alter their conduct.).

18 Alaska, Arkansas, California, Connecticut, Delaware, Hawaii, Illinois, Indiana, Iowa, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, Rhode Island, South Dakota, Virginia, Washington and Wisconsin.

19 Cal. Bus. & Prof. § 20020.

20 Arkansas, California, Connecticut, Delaware, Hawaii, Illinois, Indiana, Iowa, Michigan, Minnesota, Nebraska, New Jersey, Tennessee, Virginia, Washington, and Wisconsin.

21 *See, e.g.,* Indiana Deceptive Franchise Practices Act, Bus. Franchise Guide (CCH) ¶4140.02; Hawaii Franchise Rights and Prohibitions Law, Bus. Franchise Guide (CCH) ¶4110.01; Washington Franchise Investment Protection Act, Bus. Franchise Guide (CCH) ¶4470.01.

arbitrary). Particularly in light of these anti-discrimination provisions, franchisors should treat "similarly situated" franchisees consistently in the context of addressing violations of the franchise agreement.[22]

2. Anticipate issues in franchise agreement

Franchisors should consider whether, in light of the current economic climate and the state of the credit markets, certain standard provisions of the franchise agreement should be modified at the inception of the relationship based on the particular franchisee's circumstances. For example, franchisors should take into consideration the prospective franchisee's likelihood of obtaining financing and set realistic timelines for opening, even if that means drawing out the standard construction/conversion timelines.

Franchisors may also consider providing the franchisee with a termination right in the event that financing cannot be obtained and/or the conversion/construction work does not begin by a certain date. Any such termination right should be tightly drafted so that there is a "window" during which the franchisee may terminate upon written notice, and consideration should be given to whether a termination fee will be required in connection with the exercise of the termination right and whether the franchisor will require the franchisee to sign a general release or meet any other conditions upon termination. Finally, in appropriate circumstances, a royalty ramp-up may be considered as a way to provide relief to the franchisee in the initial start-up period.

3. Quality assurance programs/inspections to identify and monitor problems

A quality assurance program is critical to any franchise system as a means to monitor franchisee operations and ensure that franchisees comply with system standards. Quality assurance programs take on heightened importance during difficult economic times when franchisees may either be in distress or are cutting costs in order to maintain profitability. Conducting periodic quality inspections (either announced or unannounced) of franchised properties on a regular basis should be part of a comprehensive quality assurance program. Franchisees that are conditioned to expect regular inspections are oftentimes more likely to consistently maintain standards, and for those franchisees that do not maintain standards, inspections are a good way for franchisors to identify and address issues with franchisees.

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[22] Generally, case law also supports the position that franchisors may discriminate among franchisees, so long as the discrimination is not "unfair" or is justifiable. *See, e.g., Canada Dry Corporation v. Nehi Beverage Company, Inc.*, 723 F.2d 512 (7th Cir. 1983) ("proof of 'discrimination' requires a showing of arbitrary disparate treatment among similarly situated individuals or entities"); *McDonald's Business Facilities Corporation v. Werve*, 392 N.W.2d 130 (Wisc. Ct. App. 1986); *see generally* J. Michael Dady and Arthur L. Pressman, *Treating Franchisees Differently: "Hanged" if You Do, "Hanged" if You Don't?!*, ABA Forum on Franchising (October 1998).

4. Deadline extensions

Despite a franchisor's best efforts to set reasonable deadlines for conversion/construction, property improvement plan work, etc., franchisees may have difficulty meeting deadlines provided for in the franchise agreement due to a failure by the franchisee to obtain financing or an unwillingness to meet those deadlines due to hotel performance or the general state of the economy.[23] Franchisors must consider carefully whether it is appropriate under the circumstances to extend deadlines.

If the failure of a franchisee to meet deadlines is due to circumstances over which the franchisee has no (or very little) control (e.g., the lack of available credit to a well-qualified franchisee that it using its best efforts to obtain financing for the project), the franchisor may be more willing to make adjustments to deadlines. However, if a franchisee is capable of meeting deadlines and chooses not to do so due to the economy or other factors or if the failure to meet a deadline will have a significant adverse impact on the brand, the franchisor may elect to enforce the deadline without an extension. Discerning the reasons for missed deadlines and the appropriate action to take is a sometimes difficult, but critical, task.

5. Temporary royalty/advertising fee relief

In some cases, a royalty abatement or a reduction in the royalty percentage for a limited period of time may be appropriate. Alternatively, the franchisor may wish to permit a franchisee to redirect of a portion of royalties to increased local advertising expenditures or advertising fund contributions in order to increase brand awareness and drive revenue if hotel performance is an issue.

Obviously, a decision by a franchisor to decrease required royalties must be taken carefully as it will necessarily have an adverse impact on the franchisor's revenues, even if only for a limited period of time. Franchisees that have proven themselves as capable operators and that are in compliance with their franchise agreement but that may need limited financial relief in order to make it through temporary difficulties may be good candidates for this type of arrangement. Ultimately, the franchisor has to assess whether this type of relief will have the effect of improving the likelihood of the franchisee's success in operating under the brand.

6. Leverage supply arrangements

In an economic downturn suppliers may be more willing to negotiate lower prices or re-negotiate existing supply arrangements for products and services that they supply to franchisees. Franchisors should be proactive in identifying this and other opportunities for maximizing cost savings for franchisees. Taking advantage of cost saving opportunities now can not only assist those franchisees that are currently struggling but can also position the system well for an economic recovery.

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23 *See* Torto Wheaton Research/Dodge Construction/Smith Travel Research Construction Pipeline Report for November 2008, which shows a 75% increase over November 2007 in the number of guestrooms in the construction pipeline that have been abandoned.

7. Initiatives to increase revenues

Many hotel companies are disinclined to generally decrease rates (or encourage their franchisees to decrease rates) in response to the downturn as a way to increase demand due to the difficulties such a strategy presents when the hotel tries to increase rates back to pre-downturn levels when the economy recovers.[24] However, franchisors should consider other alternatives to drive business to franchisee properties, such as increasing sales training at the hotel level, offering franchisees the opportunity to participate in special customer incentive programs, including limited pricing promotions, and reallocating advertising expenditures to areas that have been hit harder by the recession.

C. Documentation

Franchisors addressing problems and issues under a franchise relationship with franchisees must be sure to carefully document any arrangement with the franchisees or other communications with franchisees relating to those issues, whether it is an accommodation to a franchisee like those discussed in the preceding section, a notification to the franchisee of a default or potential default under the franchise agreement, or a termination of the relationship.

1. Agreement Amendments

In the event that the franchisor agrees to modify the terms of a franchise agreement as an accommodation to a struggling franchisee, any such modification should be clearly addressed in a written amendment to the franchise agreement that is signed by both parties. Such changes may include deadline extensions, royalty abatements, or advertising fund contribution changes. The recitals in the amendment should include a brief explanation of any relevant background and justification for the changes. Franchisors should also consider whether it is appropriate to obtain a general release of claims from the franchisee in consideration for entering into the amendment.

2. Warning letters

Franchisors may wish to use warning letters as an initial step to communicate to franchisees that the franchisee is in violation of its franchise agreement and to propose a plan for the franchisee to become compliant with the terms of the franchise agreement before sending a formal default notice. Warning letters may be particularly useful in circumstances in which the franchisor believes that the violation is as a result of an oversight by the franchisee or where the violation is relatively minor and does not have a significant adverse impact on the hotel, the brand, or the franchisor.

Prompt follow-up by the franchisor with respect to any warning letter that is sent is critical to determine whether the issues identified in the warning letter have been resolved and, if not, to determine what course of action should be taken (e.g., additional warnings or a formal

[24] *See* Mark V. Lommano, *Discounting Rates Leads to Decreased Product Value*, Hotel & Motel Management, December 8, 2008 (http://www.hotelmotel.com/hotelmotel/Columns/Discounting-rates-leads-to-decreased-product-value/ArticleStandard/Article/detail/569228).

default notice). Sample warning letters for standards violations and payment defaults are attached as Exhibit 1 to this paper.

3. Default notices

If the franchisor decides to exercise its rights under the franchise agreement and default a franchisee based on violations of the franchise agreement, the franchisor should send a formal, written notice of default. The factual basis for the default(s) should be clearly stated in the default notice. To the extent that the franchise agreement or applicable relationship laws require a cure period, the cure period that complies with the terms of the franchise agreement and applicable law should be provided for in the letter. If no cure period is required and the franchisor does not otherwise wish to provide for a cure period, the default notice may also serve as a termination notice, in which case, the effective date of the termination and the franchisee's post-termination obligations should be set forth in the notice. A sample default notice is attached as Exhibit 2 to this paper.

4. Termination Notice

If, after the required notice and cure periods, the franchisee remains in default of the franchise agreement, the franchisor may be forced to terminate the franchise agreement. Before terminating a franchise agreement, the franchisor should confirm that it has a clear record of the default(s) that is the basis for the termination as well as a file with all correspondence relevant to the default(s) and termination, including warning notices and default notices. A sample termination notice is attached as Exhibit 3.

In some circumstances, the franchisor may be in a position to negotiate a mutual termination, which is preferable to a unilateral termination in several respects. First, if the franchise agreement is the subject of an agreed termination, the notice and cure periods required under the franchise agreement and applicable relationship laws will not apply, and, second, the franchisor can obtain a general release from the franchisee in consideration for agreeing to an early termination of the agreement. Finally, the mutual termination agreement can provide that the franchisee will pay the franchisor amounts owed to the franchisor as well as any termination fees or agreed damages. A mutual termination may be ideal when the franchisor and franchisee have a good relationship, and the franchisor and franchisee are in agreement that it is mutually beneficial for the franchise agreement to be terminated.

Exhibit 1

Sample Warning Letters

[Franchisor Letterhead]

[Date]

VIA FACSIMILE [_________] AND
FEDERAL EXPRESS

[Name]
[Title]
[Franchisee Name]
[Address]

Re: Notice of Violation - XXXXX Franchise Agreement dated [______] (the "Franchise Agreement") between XXXXXXX ("Franchisor") and XXXXX ("Franchisee") for the XXXXXXX hotel located at XXXXXXX (the "Hotel")

Dear [Name]:

This letter is to notify you that Franchisee is in violation of the Franchise Agreement. Specifically, Franchisee is in violation of Section XXX of the Franchise Agreement which requires Franchisee to pay the Royalty Fees, Marketing Fees, Reservation System Fees, National Sales Fees, and Regional Cooperative Marketing Fees by the fifteenth (15^{th}) day of each month for the preceding month and all other invoices forwarded by Franchisor or its affiliates to Franchisee and other amounts owed by Franchisee to Franchisor within thirty (30) days after Franchisee's receipt of the invoice.

As of XXXXX, the total overdue amount owed by Franchisee to Franchisor (excluding interest provided for under the Franchise Agreement) is XXXXXX ($XXXXX). A reconciliation of such amount is enclosed with this letter.

Please remit payment of all overdue amounts to Franchisor on or before XXXXXX, which is 10 business days after the date of this letter. A continued violation may lead to a formal notice of default under the Franchise Agreement. This notice is not intended to constitute an election of any remedy to which Franchisor may be entitled, nor does Franchisor waive any right which it might possess in connection with this or any other defaults arising under the Franchise Agreement. If you should have any questions regarding this matter, please call XXXX at XXXXXX.

We appreciate your immediate attention to this matter.

Sincerely,

[FRANCHISOR]

Enclosure

[Franchisor Letterhead]

[Date]

VIA FACSIMILE [_________] AND
FEDERAL EXPRESS

[Name]
[Title]
[Franchisee Name]
[Address]

Re: Notice of Violation

Dear [Name]:

This letter is to notify you of a violation of the XXXXX Franchise Agreement (the "Franchise Agreement") dated XXXX between XXXXX ("Franchisor") and XXXXX ("Franchisee") for the XXXX Hotel located at XXXXXXX (the "Hotel").

Section XXX of the Franchise Agreement provides that the Franchise Agreement may be terminated immediately upon notice from Franchisor if Franchisee fails to comply with Franchisor's quality assurance program and fails to cure any default under that program within the applicable cure period determined in accordance with such program.

A quality assurance inspection of the Hotel was conducted in XXXX. The Hotel received a failing score of XX% and was required to cure certain defaults identified during the quality assurance inspection, including XXXXXX, on or before XXXXXX. The Hotel was re-inspected on XXXXX and failed to cure the defaults identified in the XXXXX inspection and received another failing score of XX%.

The Hotel will be inspected again within thirty (30) days after the date of this letter to determine whether the defaults under Franchisor's quality assurance program have been cured. A continued violation may lead to a formal notice of default under the Franchise Agreement. This notice is not intended to constitute an election of any remedy to which Franchisor may be entitled, nor does Franchisor waive any right which it might possess in connection with this or any other defaults arising under the Franchise Agreement. If you should have any questions regarding this matter, please call XXXX at XXXXXX.

Sincerely,

[FRANCHISOR]

Exhibit 2

Sample Default Notice

[Franchisor Letterhead]

[Date]

VIA FACSIMILE TO (___) ___-____ AND FEDERAL EXPRESS

[Name]
[Title]
[Franchisee]
[Address]

Re: Notice of Default

Dear [_____]:

This letter shall serve as a formal written notice of default of the XXXX Franchise Agreement dated ______________ (the "Franchise Agreement") between ________________ ("Franchisor") and ___________ ("Franchisee") for the XXXX Hotel located at XXXXXX (the "Store"). Without respect to other events which might constitute an event of default under the Franchise Agreement, Franchisee is in default of Sections XXXX and XXXX of the Franchise Agreement which requires Franchisee to pay the Royalty Fees, Marketing Fees, Reservation System Fees, National Sales Fees, and Regional Cooperative Marketing Fees by the fifteenth (15^{th}) day of each month for the preceding month and all other invoices forwarded by Franchisor or its affiliates to Franchisee and other amounts owed by Franchisee to Franchisor within thirty (30) days after Franchisee's receipt of the invoice. As of XXXXX, the total overdue amount that Franchisee owes to Franchisor is [______________ dollars ($______)]. A statement and reconciliation of amounts owed is attached for your reference.

Franchisee must pay the overdue amount within five (5) days following Franchisee's receipt of this notice ("cure period"). If Franchisee fails to pay the overdue amount within such five (5) day cure period, Franchisor intends to immediately terminate the Franchise Agreement upon notice and without any further opportunity to cure in accordance with Section XXXX, in which event Franchisor intends to enforce all of its post-termination rights.

Nothing contained herein is intended to constitute an election of any remedy to which Franchisor may be entitled, nor does Franchisor waive any right which it might possess in connection with the franchise or this or any other default arising under the Franchise Agreement. If you should have any questions regarding this matter, please contact XXXX at XXXXXXX. We appreciate your immediate attention to this matter.

Sincerely,

[FRANCHISOR]

Exhibit 3

Sample Termination Notice

[Franchisor Letterhead]

[Date]

VIA FEDERAL EXPRESS, ELECTRONIC MAIL AND FACSIMILE XXXXXX

[Name]
[Title]
[Franchisee]
[Address]

Re: XXXX Hotel Franchise Agreement dated XXXXX (the "Franchise Agreement") between XXXXX ("Franchisor") and XXXX (the "Franchisee") for the XXXXX Hotel located at XXXXXXX (the "Hotel") - Notice of Termination

Dear [_____]:

This letter shall serve as a formal written notice of termination of the Franchise Agreement. Without respect to other events which might constitute an event of default under the Franchise Agreement, Franchisee is in default of Section XXXX of the Franchise Agreement which requires Franchisee to pay the Royalty Fees, Marketing Fees, and national sales fees by the fifteenth (15^{th}) day of each month for the preceding month and the Reservation System Fees and other amounts owed by Franchisee to Franchisor within thirty (30) days after Franchisee's receipt of the invoice. In Franchisor's XXXXXX letter, Franchisor indicated that the Franchise Agreement would be immediately terminated if Franchisee failed to cure such payment defaults within ten (10) days from Franchisee's receipt of the XXXXX letter (the "Cure Period").

Franchisee did not cure the payment defaults during the Cure Period and has still not cured the payment defaults. Therefore, Franchisor is hereby exercising its right to terminate the Franchise Agreement immediately upon notice without any further opportunity to cure in accordance with Section XXXXX of the Franchise Agreement and Franchisor's XXXXXX letter to Franchisee.

The Franchise Agreement, and all of Franchisee's rights thereunder, will terminate immediately upon receipt of this notice by Franchisee ("Termination Date"), and Franchisee must comply with all post-termination obligations as set forth in Section XXXX of the Agreement, including, without limitation, the following:

- Franchisee must cease operation of the Hotel as a XXXX Hotel and not thereafter, directly or indirectly, represent to the public or hold itself out as a present or former franchisee of Franchisor;

- Franchisee must immediately and permanently cease to use, by advertising or in any other manner whatsoever, the name “XXXXX,” all variations thereof and all other XXXXXXX Proprietary Marks, any other identifying characteristics and marks of the System, and all confidential methods, procedures and techniques associated with the System;

- Franchisee must immediately remove from Franchisee’s place of business, and discontinue using for any purpose, any and all signs, fixtures, furniture, furnishings, equipment, advertising materials, stationery, supplies, forms or other articles which display the Proprietary Marks or any distinctive features or designs associated with the System. Any signs containing the Proprietary Marks which Franchisee is unable to remove within one day after the Termination Date must be completely covered by Franchisee until the time of their removal;

- Franchisee must, at its expense, promptly remove all distinctive signs, emblems, amenities and other items bearing the Proprietary Marks, change directory and other listings to remove all reference to such Proprietary Marks and to any telephone or other number used generally by other XXXXX Hotels for reservation or other purposes and make such specific additional changes as Franchisor may reasonably request to prevent any possibility that the public may confuse the Hotel with a XXXXX Hotel. Until all such modifications and alterations are completed, Franchisee must take all such actions as Franchisor may reasonably require to advise all customers and prospective customers that the Hotel is no longer associated with the System;

- Franchisee must cancel any assumed name or equivalent registration which contains the name "XXXXXX" or any variation thereof or any other Proprietary Mark, and Franchisee must furnish Franchisor with evidence satisfactory to Franchisor of compliance with this obligation within thirty (30) days after the Termination Date;

- Pursuant to Section XXXX of the Franchise Agreement, Franchisee must pay Franchisor as liquidated damages a lump sum equal to [_______________________ ($_________)];

- Franchisee must promptly pay all sums owing to Franchisor and its Affiliates, and all suppliers. The current outstanding amount owed to Franchisor and its Affiliates is [_______________________ ($_________)], as detailed in the attachment to this letter; and

- Franchisee must immediately deliver to Franchisor the Manual, instructions, Software and accompanying documentation, and all other materials provided by Franchisor related to the operation of the Hotel, and all copies thereof.

Nothing contained herein is intended to constitute an election of any remedy to which Franchisor may be entitled, nor does Franchisor waive any right which it might possess in connection with the franchise or this or any other default arising under the Franchise Agreement.

Please contact XXXXX at XXXXXXX if you have any questions.

Sincerely,

[FRANCHISOR]