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Will New Legislation Shift the Balance of Power in the Franchisor-Franchisee Relationship?

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Key Take: *Keep an eye out for potential legislation that could rein in hotel franchisors.*

Most hoteliers believe that franchisors have the upper hand in negotiating hotel franchise agreements. Some franchisors attempt to take a “take-it-or-leave-it” approach to negotiations. Many franchise agreements afford franchisors wide latitude in maintaining their franchise systems and give franchisors flexibility to modify their brand standards and system fees unilaterally.

New proposed legislation in New Jersey, however, has the potential to shift the balance of power – at least somewhat – between franchisors and franchisees.

The proposed legislation, which made headlines in 2023, is New Jersey’s Assembly Bill No. 1958. It has not been enacted yet – the bill stalled in the state’s

legislature – but is expected to return in the next legislative session.

The proposed New Jersey bill contains a list of hospitality franchisor activities that would be considered a violation of the New Jersey Franchise Practices Act. The proposed legislation, among other things, would make it a violation “for a hospitality franchisor or an entity owned or controlled by the franchisor or affiliated under common ownership by the franchisor” to “[e]stablish, directly or indirectly, a franchisor-owned or franchised outlet engaged in a substantially identical business to that of the franchisee within the franchisee’s exclusive or protected territory, if the franchise agreement provides for either.” Typically, a hotel franchisee will negotiate an area of protection which restricts the franchisor from opening, within an agreed restricted area, another hotel under the same brand that is being franchised. It is unclear at this juncture whether the proposed legislation would expand an area of protection to cover other brands within the franchisor portfolio (for example, whether Marriott would be restricted from opening a luxury Ritz-Carlton near an upper upscale Westin or, for that matter, an upper midscale Fairfield). It is also unclear whether the proposed legislation would restrict the franchisor’s right to acquire and/or re-flag existing hotels within the franchisee’s area of protection. Given this uncertainty, many fear that the proposed legislation may actually have the opposite effect, and result in franchisors being unwilling to agree to any brand-specific area of protection for fear that it could result in portfolio-wide restrictions.

In addition, the proposed New Jersey legislation would make it a violation for the franchisor to “[m]ake any material change in the terms of the franchise agreement . . . through any unilateral change, made by the franchisor, to any operations manual or through any bulletin or other communication, unless such change involves material health, safety and welfare protections for

the franchisee's guests or workforce." The operations manual outlines the brand's procedures, policies and standards and, according to franchisors, is essential for maintaining uniform brand standards across all franchised locations and ensuring that customers have a consistent experience no matter which location they visit. Franchisors routinely reserve the right to modify their operations manuals, without having to amend their franchise agreements, in order to adapt their franchise systems to address changing technologies, legal requirements, customer preferences, demographics and other market conditions. These sorts of changes to the franchise system sometimes require franchisees to pay additional fees and incur additional expenses. The proposed legislation may change this framework. Supporters of the proposed legislation believe that prohibiting unilateral changes to the operations manual would avoid unilaterally imposed fees without proper disclosure and approval. Franchisors argue, however, that the proposed legislation will restrict their ability to effect brand-wide change and thereby limit the technological and procedural upgrades and efficiencies that inure to their customers' benefit.

The proposed New Jersey bill would also change how loyalty points are reimbursed by making it a violation for a franchisor to "to [s]ell points or credits in a hospitality franchisor's loyalty program to a guest for the purpose of permitting the guest to redeem points for a specific stay at a specific franchisee's facility without compensating the franchisee for the stay at no less than the franchisee's lowest publicly advertised rate for that stay or the value of the points sold, whichever is less." Frequent guest programs like Hilton Honors, Wyndham Rewards, World of Hyatt, Marriott Bonvoy and IHG One Rewards have been a significant engine used to create brand loyalty and drive growth. Hotel brands believe the proposed legislation would create significant obstacles for hotel loyalty programs and make it difficult for guests to use or accrue loyalty points while staying at New Jersey hotels. If the

proposed legislation is enacted, it is not clear whether brands would either need to develop a New Jersey specific hotel loyalty program or discontinue New Jersey franchised hotels from participating in their loyalty programs.

Importantly, New Jersey is not the only government authority looking into these issues, and hospitality is not the only industry being targeted. In addition to the proposed New Jersey bill, there are rumblings at the Federal Trade Commission (FTC) of potential changes that could broadly impact the franchisor-franchisee relationship. The FTC announced in March 2023 that it was seeking public comment on franchise agreements and franchisor business practices, including, how franchisors exert control over franchisees and their employees. Most of the FTC's questions appear to reflect a concern regarding whether franchisors treat franchisees unfairly and whether franchisees have sufficient bargaining power. The FTC's solicitation suggests a desire to scrutinize franchising practices and protect franchisees. Among other issues in focus, the FTC's request seeks public comment on the ability of franchisees to negotiate the terms of franchise agreements before signing (rather than being presented on a take-it-or-leave-it basis), and on the ability of franchisors to unilaterally make changes to their franchise systems. The FTC received over 5,500 comments in response to its request for information, and many industry stakeholders believe that the FTC's request for information is setting the stage for new rules that will further regulate the franchise industry – affecting both hospitality and non-hospitality brands.

The U.S. hotel industry should pay close attention to the tide of these new proposed laws, rules and regulations. While the proposed New Jersey bill is not yet in effect and any legislation that comes out of the FTC's request for information is not yet certain and still in its infancy stage, they could have a ripple effect in other jurisdictions and dramatically shape the business and legal landscape in which hoteliers

do business in 2024 and beyond. We will continue to monitor and assess these developments.