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ABA AMERICAN BAR ASSOCIATION
Forum on Franchising

The Franchise Lawyer

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Message from the Chair

By Jason Adler, ServiceMaster Brands

JASON ADLER
ServiceMaster Brands

A huge thank you to all of you who attended the 48th Annual Forum on Franchising in Orlando, Florida! As I write this, I have just returned to the office and am heroically attempting to work through the emails that multiplied while I was away (key word: *attempting*). I hope you found the Annual Meeting as rewarding as I did – whether you deepened your expertise, discovered something new(ish), or just reconnected with old friends and made a few new ones along the way.

Once again, thank you to our outstanding co-chairs, Caroline Fichter and Dan Oates, and to the planning committee for their year-long efforts to plan such a wonderful meeting. I also want to thank all our speakers for spending so much time writing the papers and preparing the presentations for the two plenaries, three intensives, and 24 workshops. A special shoutout to Ann MacDonald and John Doroghazi for their work on the *Annual Developments* – which, for those who caught the inside joke, definitely rated higher than a six-seven.

For those asking about materials, papers are currently available to Annual Meeting registrants on the Cvent App. Six months after the meeting, they will be indexed and made available to all members under the "Law Library" tab of the Forum website.

And because the Forum never rests, planning is already underway for the 49th Annual Meeting – October 14–16, 2026, in Toronto, Ontario, Canada. (Friendly reminder: now is a good time to check your passport's expiration date!) Forum Governing Committee members Robert Einhorn and Kendal Tyre are already crafting another great program for next fall.

As I mentioned during Friday's remarks at the Annual Meeting, there are *so many ways* our members can get involved with the Forum throughout the year:

- **Write** for one of our publications – *The Franchise Law Journal* or *The Franchise Lawyer*. Editors-in-Chief Aaron-Michael Sapp (Asapp@Chengcohen.com) and Justin Sallis (Justin.Sallis@Lathropgpm.com) would love to hear from you. Whether you have a fresh take

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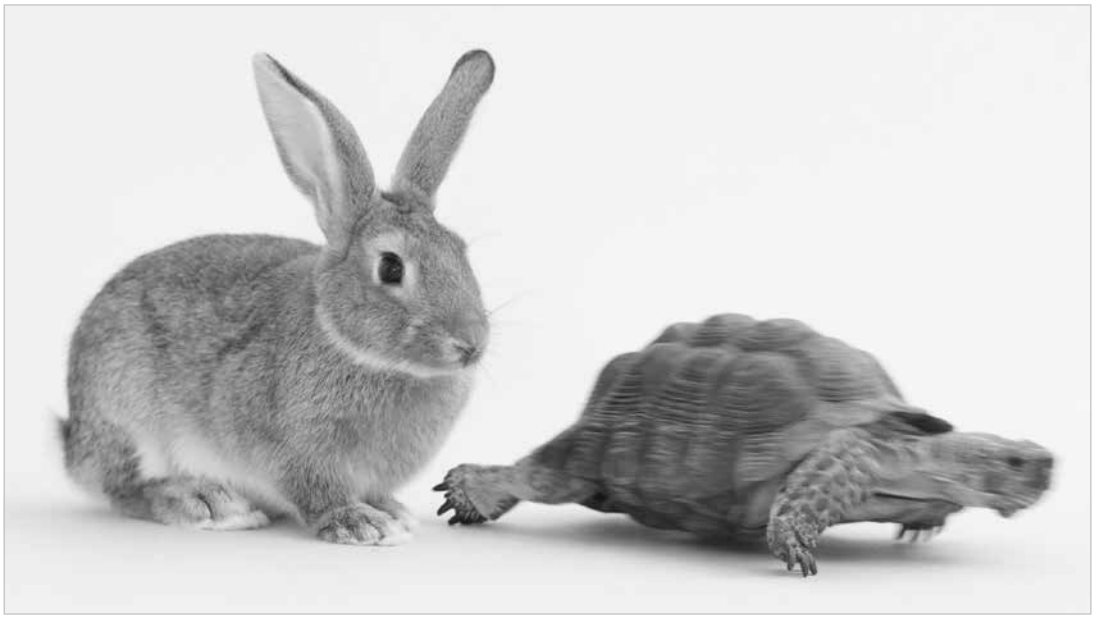
Editorial Board





The Tortoise and the Hare: Challenges, Considerations, and Practical Tips for Leveraging AI Chatbots for Franchise Sales

By Shelbey Lindahl, Cheng Cohen LLC



The franchise industry continues to grow, with an estimated increase of 20,000 units in 2025 according to the International Franchise Association's 2025 *Franchising Economic Outlook* report. *See* Int'l Franchise Ass'n, 2025 *Franchising Economic Outlook Report* at v (2025), https://indd.adobe.com/view/41aaf895-c7f7-43ff-9004-9455305199f3. As a result of the increasing number of competitive businesses, franchisors have become savvier, leveraging technology in creative ways to drive recruitment, improve system efficiency, and enhance their brand presence to differentiate themselves, including by using artificial intelligence.

Artificial intelligence, or "AI," is a system of technology that enables computers and machines to "simulate human learning, comprehension, problem solving, decision making, creativity and autonomy." *What is artificial intelligence?*, IBM THINK, https://www.ibm.com/think/topics/artificial-intelligence. While some AI models may be used by franchisors to gather surface-level information about prospective leads, other models can interact in more sophisticated ways – for example, by having in-depth conversations with prospective franchisees about their business. AI can respond to human languages and understand questions and thought processes. It can learn information and make detailed recommendations based on both its learning and prior knowledge. *Id.* AI may, in some instances, effectively replace human interaction, including in franchise sales. *Id.*

Before the end of 2025, an estimated 85 percent of customer service organizations will have deployed customer-facing generative AI technology, such as chatbots and messaging platforms, aimed at improving customer experience and corporate efficiency. Gartner,

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Gartner Survey Reveals 85% of Customer Service Leaders Will Explore or Pilot Customer-Facing Conversational GenAI in 2025 (December 9, 2024) https://www.gartner.com/en/newsroom/press-releases/2024-12-09-gartner-survey-reveals-85-percent-of-customer-service-leaders-will-explore-or-pilot-customer-facing-conversational-genai-in-2025. AI is forecasted to continuously grow, eventually hitting a peak of an estimated 729.11 million users. Statista, *Number of Artificial Intelligence (AI) Tool Users Globally from 2020 to 2030* (2024), https://www.statista.com/forecasts/1449844/ai-tool-users-worldwide (showing a total increase of 414.7 million users, amounting to a 131.91% increase, between 2024 and 2030); *see also* Vena Solutions, *80 AI Statistics Shaping Business in 2024* (July 18, 2024), https://www.venasolutions.com/blog/ai-statistics ("There were more than 250 million users of AI tools around the world in 2023, which is more than twice the quantity tracked in 2020."). The prevalence of AI far surpasses the growth of the franchise industry, and frankly, franchise laws did not see that coming.

While AI continues to evolve and companies become more innovative in leveraging their personnel and resources, franchise laws and regulations have generally remained stagnant for decades. A franchisor implementing a chatbot for franchise sales may seek compliance advice, only to find there is no guidance on how to register or otherwise align its AI sales practices with the existing regulations. While simply gathering contact information and presenting it to a franchisor likely does not rise to the level of acting as a franchise broker, when a chatbot provides answers to questions about potential earnings, the franchise relationship, and how to be a successful franchisee, franchisors should be concerned. Until regulations and technology align, franchisors must navigate this uncertainty and determine how to make a good faith effort to lawfully integrate AI into their sales processes.

Current Landscape of Franchise Laws & Regulations

Franchise Brokers

A "franchise broker" is an individual or organization that operates as an independent agent to promote, offer, and arrange for the sale of a franchise opportunity on a franchisor's behalf. 16 C.F.R. § 436.1(j). Franchise brokers operate as intermediaries between a franchisor and a prospective franchisee during the sales process and are typically paid a commission by the franchisor. *Id.* The FTC Rule does not regulate franchise broker registration.

New York and Washington are the only two states that require brokers to register with a state administrator. 13 NYCRR § 200.11; RCW 19.100.140. Franchisors may not use franchise brokers in New York or Washington unless the brokers are licensed in those states. New York and Washington require franchise brokers to register with the state and provide certain information about the entities and/or individuals selling franchises. N.Y. Gen. Bus. Law § 683(1); RCW 19.100.140; *see also* S.B. 919, 2023-2024 Leg., Reg. Sess. (Cal. 2023) (explaining a broker registration process for the State of California that, if enacted, would require similar registrations for brokers in a third state).

Franchise Sellers

While seemingly similar to a broker, the FTC Rule defines a "franchise seller" as a person that offers for sale, sells, or arranges for the sale of a franchise. 16 C.F.R. § 436.1(j). "Person" can include any individual, group, association, or entity, which includes a franchisor and its employees, representatives, agents, subfranchisors, and third-party franchise brokers who engage in franchise sales activities. 16 C.F.R. § 436.1(n). A franchisor's employees who are involved with the franchise sales process can also be considered sellers. Franchise brokers are responsible for complying with registration requirements, but franchisors are responsible for filing franchise seller forms on behalf of any authorized sellers. *See e.g.*, NASAA, *Form D – Franchise Seller Disclosure Form*; Ill. Attorney General, *Franchise Registration Form D*. The purpose of this filing is to confirm that the franchisor is aware that a franchise seller is offering franchises on its behalf.

While registration requirements exist for both brokers and sellers in New York and Washington, other states merely require franchisors to register franchise sellers. California, Hawaii, Illinois, Indiana, Maryland, Minnesota, North Dakota, and Rhode Island only require the filing of franchise seller forms with information about authorized sellers. *See, e.g.*, Cal. Dep't of Fin. Protection & Innovation, *Form E – Sales Agent Disclosure Form*; Ind. Secretary of State, *Franchise*, https://securities.sos.in.gov/general-information/franchise/ (last visited May 8, 2025); Md. Attorney General, *FRANCHISES*, https://www.marylandattorneygeneral.gov/Pages/Securities/franchise.aspx (last visited May 8, 2025); R.I. Dep't of Bus. Reg., *Franchise Seller Disclosure Form*,

https://dbr.ri.gov/sites/g/files/xkgbur696/files/documents/divisions/securities/FranchiseSellerDisclosureForm.pdf (last visited May 8, 2025).

Federal Registration Requirements & Regulatory Guidelines

The North American Securities Administrators Association ("NASAA") recently requested public commentary for a proposed federal franchise broker registration act, which would allow states to streamline the registration process through a centralized record and provide a model for states to regulate brokers and sellers. N. Am. Sec. Admin. Ass'n, *Request for Public Comment: Franchise Broker Act* (May 13, 2024), available at https://www.nasaa.org/wp-content/uploads/2024/05/Request-for-Public-Comment-Franchise-Broker-Act_5-13-2024.pdf. Though this federal registration is not yet reality, it is anticipated that such a system would gather and index similar information to what is already required in New York and Washington. *Id.*

The FTC Rule regulates the content that brokers and sellers can provide to prospective franchisees. *See* 16 C.F.R. § 436.9. For example, brokers and sellers are prohibited from providing prospects with any indications of potential earnings, success, or reasons why they might be more successful than others in the franchise system. Instead, they are limited to discussing only those "financial performance representations" ("FPRs") outlined in Item 19 of the franchise disclosure document ("FDD"). *See* 16 C.F.R. § 436.1(e). If a franchisor includes FPRs in its disclosure document, the FTC Rule mandates that the disclosure document clearly disclaims the data as a guarantee of any actual earnings a prospective franchisee will achieve. 16 C.F.R. § 436.5(s). Franchisors must consider the legal implications of using chatbots to both initiate contact with prospects and respond to inquiries. Where an AI model can learn from Item 19 of a franchisor's FDD, it may not censor itself to only provide information within the FDD itself. In other words, it may build on the information in Item 19, providing impermissible and inaccurate FPRs.

Several states also require the registration of materials advertising the franchise opportunity, including California, Maryland, Minnesota, New York, North Dakota, and Washington. For AI software models that proactively engage prospective franchisees in discussions about franchise sales, additional federal and state laws may apply, such as the Telephone Consumer Protection Act (TCPA), which regulates unsolicited communication; and laws governing the regulation of initial messages and content that could be considered an "advertisement" for the franchise opportunity. 47 U.S.C. § 227; 47 C.F.R. § 64. Therefore, it is crucial for a franchisor to carefully analyze how each unique AI model interacts with potential franchisees and determine which laws may be implicated.

Are Chatbots Sellers, Brokers, or Neither?

Although AI software is developed by companies that can file broker forms where applicable, the question becomes whether such registration is necessary. Chatbots, in theory, would be required to register under some state laws as sellers because they are facilitating the sale of franchises on behalf of a franchisor; however, registering a non-human "person" as a seller falls outside the scope of current state laws and the FTC Rule, creating a gap between compliance requirements and the practical measures franchisors are taking today. A chatbot does not have principals, officers, or directors, will not have been convicted of a felony, cannot file a bankruptcy petition, and cannot legally attest to the required statements in a broker form (RCW 19.100.140; WAC 460-82; Washington Broker Form). Regulations, interpreted as currently written, would require AI companies to file mostly incomplete broker registration forms, which is neither helpful to state regulators that seek to enforce their state provisions, nor to franchisors in charge of who (or what) is selling franchises on its behalf and who can be held liable for any wrongdoing.

Nonetheless, franchisors across various industries are already utilizing AI software, including chatbots, not only to assist in franchise support and internal operations and to get ahead of their competitors, but also to actively participate in the sales process by responding to commonly-asked questions about the FDD and the franchise system—situations that franchise law at all levels has yet to contemplate.

When Robots Meet Regulation

While it may seem that a fast-paced technological industry will drive franchise laws to evolve, this has not been the case in practice. Until a clear answer emerges as to whether chatbots for franchise sales are brokers, sellers, or simply an unregulated loophole, franchisors must exercise their best judgment to protect their franchise systems while strategically taking risks to stay ahead of the competition. Here are some practical

considerations to keep in mind when using AI as a tool for franchise sales:

1. *Avoid overconfidence: Liability for wrongdoing remains with the franchisor*

Franchisors are required to oversee the information provided to brokers and sellers and the disclosures being made by those brokers and sellers to prospects. Toward the end of 2022, NASAA began to strictly regulate the use of questionnaires and acknowledgments by franchisors under the guise that these tools were being used to insulate franchise systems from franchisees who believed they had been fraudulently induced or misrepresented regarding the franchise opportunity. *NASAA Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgments* (Sept. 18, 2022), available at https://www.nasaa.org/wp-content/uploads/2022/09/NASAA-Franchise-Questionnaires-and-Acknowledgments-Statement-of-Policy-9-18-2022.pdf. An underlying rationale of this regulation is that franchisors should be ultimately responsible for the sales process, including any disclosures made to prospects by third-party brokers and sellers. *See id*.

Franchisors also bear the responsibility of ensuring AI platforms respond to questions and engage potential franchisees using accurate, current, and compliant information. *See* 16 C.F.R. § 436.6(a). Providing inaccurate information about a franchise opportunity can tarnish a brand's reputation and strain relationships with potential franchisees, which, in many cases, is a risk that often outweighs the cost of investing in an internal risk management system to mitigate these possibilities.

Because AI software enhances its responses based on the information it learns over time, chatbots could expose franchisors to potential lawsuits and attract misaligned or ill-informed franchisees as it processes more data. The continuous learning model of AI is particularly risky when the information the AI uses to generate responses is not aligned with the most up-to-date FDD. The FTC Rule prohibits brokers and sellers from combining data from multiple historical disclosure documents to produce information, and chatbots cannot be allowed to operate in this manner, either.

The vast uncertainty about how franchise laws will interact with the use of AI software also begs the question whether a franchisor must ensure that a chatbot understands differences in the franchise offering at the state level, such as the applicability of certain provisions in a franchise agreement due to a state-specific rider, or the presence of fee deferral for a franchisee in one state but not another. Franchisors must carefully consider the risks of training AI systems on what information can be shared with individuals, while also determining when to direct the chatbot to escalate communication to a human representative. The risk ultimately depends on the AI's ability to accurately determine the location of its chat partner, verify that location relative to the laws governing it, and act accordingly—all of which is extremely difficult to implement effectively in practice.

2. *Assumptions can be dangerous: Franchisors must thoroughly vet AI vendors*

Franchisors should do extensive investigation into the chatbot and AI software platforms available to them. To ensure smooth and effective implementation of AI for franchise sales, franchisors should make sure that the vendor contract with the AI company addresses all potential scenarios that could lead to liability for the franchisor.

Franchisors should contractually require AI companies they work with to review and comply with franchise disclosure laws and the boundaries of how the chatbot may operate in light of the laws. Franchisors can also ensure the contract includes a mechanism for auditing or reviewing the software periodically to ensure it provides accurate information, allowing for adjustments to be made if necessary. A robust indemnification provision is crucial to protect the franchisor in the event of inaccurate or inappropriate disclosures by the AI software. Since there is no one-size-fits-all approach to using AI for franchise sales, asking the right questions is essential to determine whether the implementation will enhance the system's success or instead become a costly headache.

3. *Consistency is key: Humans will still be required for successful implementation of AI*

Chatbots and similar AI technologies can eliminate time constraints and operational inefficiencies when engaging with potential franchisees, as many chatbot services provide around-the-clock support and immediate responses to inquiries. Given the current labor market and constraints on resources, many franchise brands may struggle to hire large recruitment teams, often resulting in delayed communication with interested candidates. Chatbots enable brands to enhance their presence and maintain consistent, hyper-targeted

communication with prospective franchisees—often in a manner that is far more efficient than relying on human staff to manage the same interactions.

However, if franchisors fail to continuously monitor the information fed into the software and any gaps or over-disclosures in the responses provided, franchisors may expose their system to significant risk. Before implementing AI software in a franchise system, it is crucial to consider the responsibilities and capabilities of the humans behind the technology. Ensuring that the franchise brand is accurately represented and that an effective quality control process is in place—where a human representative can intervene if necessary—helps mitigate potential issues. Relatedly, integrating AI tools at carefully chosen, intentional points in the franchise sales process will be most effective to ensure that the franchisor's team is not overwhelmed, while also maximizing the AI software's impact in driving franchise system growth.

4. *The fastest does not always win: Cookie-cutter communication brings unmotivated, underqualified franchisees*

An inherent benefit of using AI is that it allows a franchisor to efficiently implement a consistent method of communication with prospective franchisees—regardless of their location, level of interest, personal demographics, or other factors—thereby streamlining the process of growing the franchise system. However, chatbots can create a one-size-fits-all approach to franchise sales, quickly making one franchise program appear indistinguishable from others on the market. This approach also shifts the focus away from a franchisor's ability to attract qualified, engaged prospects, and instead lays the groundwork for a franchise system with underqualified franchisees, failed locations, and potential litigation. Moreover, while AI can assess objective criteria for evaluating a franchisee and their qualifications, subjective factors—such as how well a franchisee will align with the culture of the system—cannot be fully determined through a messaging platform alone.

While AI is revolutionizing how we live and work across industries, it will never fully replace face-to-face communication and personal interactions when selling franchises. Franchisors should aim to strike a balance between efficiency and meaningful, purposeful exchanges with prospects to ensure that the franchise system grows successfully. This could mean intercepting AI chatbots at a defined time in the franchise sales process or mixing AI communication with personalized human conversations.

5. *Perseverance leads to success: Good-faith compliance and continued diligence will benefit franchising in the long run*

As stated previously, franchise laws have made no attempt to keep pace with technological advancements. Despite the stagnation, there remains a risk that, at any time, state regulators may begin requiring the registration and documentation of AI platforms used as sellers or brokers. To take a cautious approach in light of the uncertainty surrounding the intersection of franchise law and AI, franchisors can require in the contract that the AI company file the appropriate broker form(s) in the states where the franchise operates and/or in states where franchisors are likely to receive inquiries from prospective franchisees; doing so demonstrates a good faith effort to comply with any future interpretations of broker and seller registration requirements.

Most importantly, franchisors should stay informed about the latest developments in AI advancements and franchise regulations, as well as other laws impacting the industry such as data and privacy laws. Franchisors should consult with attorneys to ensure that all required protections are in place in contracts with AI companies, and to assess whether using a chatbot or similar AI technology for franchise sales could be beneficial for the franchise system. If franchisors and their representatives adopt an aligned, compliant approach to using AI for franchise sales, state and federal regulators are more likely to recognize the positive impact of these tools and regulate them accordingly.

Conclusion

AI has revolutionized how people interact, communicate, and conduct business. As with any business decision, there are numerous factors to consider before implementing AI software to help develop a franchise system. While the law has not evolved alongside the rapid changes in technology, it is only a matter of time before regulators at the state and federal levels begin to scrutinize how AI is used to assist franchisors in the franchise sales process. Until a clear answer emerges, a good-faith effort to comply with existing regulations while embracing the latest technologies is the most effective way to ensure that a franchise system grows in a stable—and compliant—manner.

Maybe slow and steady will win the race after all! ■

Applying the Principles of *Getting to Yes* to Franchise Mediation

By Brian Balconi, Mediation Services and
Michael Sturm, Lathrop GPM LLP

In contrast to its nearly forgotten contemporaries like the cassette tape deck and Rubik's Cube, Roger Fisher and William Ury's seminal book on negotiation, *Getting to Yes*, has maintained its vitality in the five decades since its original publication in 1981. ROGER FISHER, WILLIAM URY & BRUCE PATTON, GETTING TO YES (3d ed. 2011). In addition to bringing back one of these author's (Michael's) memories of late-night negotiation sessions while taking Professor Fisher's class in law school, rereading *Getting to Yes* highlights the continuing utility of its observations in the negotiation and mediation process. Moreover, these principles have particularly useful application to mediations in the franchise context, as discussed below.

Separate the People from the Problems

The first principle discussed in *Getting to Yes* is to separate the people from the problem. FISHER, URY & PATTON, *supra* at 19. Franchise disputes often involve strong-willed businesspeople on each side, who may have a long history of distrust. Independent of any legal issues in the particular case, franchisees may believe they received insufficient support and were taken advantage of. The franchisor may believe the franchisee caused its own troubles by refusing to "follow the system." The people on the franchisee side may be equal business partners, majority/minority owners, or even spouses. On the franchisor side, there may be a business executive and/or in-house counsel, each with bosses to report to.

For the lawyers, franchise litigation is a repeat-player network. Often the lawyers have their own history with each other, positive or otherwise. Litigation, including franchise litigation, involves an intense winner-take-all environment, with lawyers working to leave a favorable impression on their client. In front of clients, franchisee litigators want to prove they are a worthy advocate by passionately telling the story of how their client was wronged and that the franchisor is legally (and perhaps morally) to blame. Similarly, franchisor lawyers want to show their clients they are zealous advocates and the law and contract language is on their side.

As a young lawyer, one of the authors (Brian) was representing a franchisee and was seen joking around with the franchisor's attorney while waiting for a hearing to begin. This young naïve litigator was scolded: "you can't be seen as friendly with the other side; the client will think that you are in cahoots with corporate!" That is litigation, but mediation is different. Unlike the adversarial process, mediation is a collaboration to arrive at a mutually acceptable resolution.

Mediation is not intended to produce a winner and loser. A successful mediator will set the tone of the mediation so that the attorneys and parties can focus their energy on finding common ground, problem solving, and compromise. Additionally, a mediator will use private sessions and even separate meetings with each lawyer in order to neutralize the personalities and focus on moving the negotiations in a positive direction. The mediator will endeavor to ensure that each attorney is able to work toward a resolution while still being viewed as a zealous advocate for their client, and not looking soft or "in cahoots" with the other side.

Focus on Interests, Not Positions, and Invent Options for Mutual Gain

One of the key insights of *Getting to Yes* is that negotiations are more likely to lead to better outcomes if negotiators focus on interests, not positions. FISHER, URY & PATTON, *supra* at 42. A "better outcome" in this scenario is a fair, durable agreement (assuming reaching an agreement is possible), reached efficiently and without damaging the parties' relationship. Almost always, negotiators in franchise cases have interests apart from getting the most money possible or, on the other side, paying as little as possible. Interests can be explored pre-mediation, not only for one's own side, but also by considering the other side's likely interests and directly asking "why?" during the course of a mediation. An effective mediator can facilitate this

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by probing the parties for their interests, rather than only focusing on their positions.

Getting to Yes urges negotiators to use objective criteria to present and value proposed settlement alternatives, as opposed to making seemingly arbitrary demands. *Id.* at 82. In a money-focused negotiation, for example, rather than just proclaiming "I won't take a dime less than $200,000," only to do so hours later in order to make a needed deal, a negotiator could provide justification through a damages model with a defined theory and assumptions. If persuasive counterarguments require modification of the claimed amount, then there is a principled basis for doing so. On the other hand, in the absence of such arguments, the principled position has greater force and staying power in the negotiation. As a tactical matter, *Getting to Yes* suggests that mediators steer the parties to present the principled basis first, and attempt to walk though and obtain agreement to the individual components of the analysis with the other side, rather than presenting a conclusion (which will likely become the focus) and then providing the explanation.

Another basic tenet of *Getting to Yes* is exploring options for mutual gain. *Id.* at 58. Particularly in franchising, it is rare for all aspects of a dispute to represent a zero-sum game, where any gain by one party represents an equal loss to the other. Perhaps the franchisor would be willing to concede on a financial payment from the franchisee in exchange for a much-needed upgrade to the franchisee's business. The franchisee may agree to make a larger payment if given more time to do so. *Getting to Yes* also suggests maintaining confidentiality of each side's idea generation with the mediator. Each party's private sessions with the mediator (either before or during the mediation) provide an excellent opportunity for confidential idea generation that may ultimately move the discussions forward. It is standard practice for mediators not to share what they have learned in such private sessions without express consent.

Getting to Yes also introduces the idea of the BATNA, or Best Alternative to a Negotiated Arrangement. *Id.* at 99. At the most basic level, the BATNA asks "what will I do if the negotiation fails?" The answer necessarily informs negotiation strategy and the evaluation of the other side's proposals. Strengthening your side's BATNA (more colloquially, devising a better backup plan) may allow a party to walk away from unproductive or unfair negotiations. Similarly, thoughtful consideration of the other side's BATNA may provide greater leverage, but also permit more effective consideration of opportunities for mutual gain and an understanding of the interests at stake in the mediation.

Applying the Principles to Franchise Termination Litigation

Disputes in franchising are particularly well-suited for application of these principles. As noted above, the parties to the dispute typically have been in a longstanding business relationship rather than being strangers to one another. They most often will have principled interests that go beyond payment of a sum certain for a specific episodic event. And there will often be the possibility of inventing options for mutual gain (or, at least, limiting respective losses). In some cases, mediation may result in the parties continuing the franchise relationship even if that was not contemplated when the dispute began.

One example is in the context of a termination for an alleged violation of brand standards. At a high level, this could be considered a binary legal dispute: Either the franchise agreement is terminated or it is not. From a positional basis, the franchisor could argue it had a right to terminate based on the violation and that all post-termination provisions of the franchise agreement, including de-identification and sale of equipment to the franchisor at its depreciated value, should be applied immediately. On the other hand, the franchisee may claim that the franchisor's lack of support or matters out of the franchisee's control caused the noncompliance, or that the non-compliance was immaterial or was arbitrarily enforced by the franchisor, and thus, that application of the post-termination remedies in the franchise agreement would cause an unnecessary hardship out of proportion to the harm to the franchisor.

In some egregious situations, the franchisor may believe that system protection interests override any countervailing considerations. In others, however, the mediator may assist the parties in recognizing that there are important interests on both sides and that it is possible to invent solutions for mutual gain or avoidance of unnecessary loss. A settlement can seek to balance and accommodate those interests, as opposed to the blunt instrument of a court judgment. In this situation, the franchisor has an interest in uniformity and quality of operations for the benefit of the system as a whole. The franchisee potentially has an interest in continuing in business and definitely has an interest in not losing its investment. In this situation, the mediator may provide a framework

for the franchisor to realize its interests may be best served by providing additional training and support, either in connection with a conditional reinstatement subject to specified improvement, or for a limited period in which the franchisee could attempt to sell the franchised business in order to recoup some or all of its investment.

Applying the Principles to Franchise Non-Compete Disputes

Another common issue in franchise disputes relates to enforcing the non-compete provision in franchise agreements upon expiration of the agreement, when the franchisee does not intend to renew the franchise agreement and begins to operate a competitive independent business.

In a negotiation, lawyers typically focus on the positions of the parties, as opposed to interests. Which state law applies? What case law supports the party's case? Is the non-compete reasonable in time and scope? Ultimately, the franchisor's lawyer's position is that the non-compete is fully enforceable, while the franchisee's lawyer's position is that it's not enforceable and/or the balance of equities tips in the franchisee's favor.

A mediator may be more successful at making progress toward a settlement if he or she focuses on the parties' interests. The franchisor's interest is to protect proprietary information and unfair competition from a franchisee that received the benefits of training and operational support for the term of the franchise agreement. The franchisor also wants to protect existing franchisees, who are likely watching the litigation play out. If the franchisor doesn't enforce the non-compete, other franchisees may leave the system and the franchisor may face a waiver defense if it attempts to enforce its non-compete in a different case. Additionally, a franchisor may want the royalties from an active franchisee and may be wary of having to list a non-renewal in Item 20 of its Franchise Disclosure Document (FDD).

The franchisee's interest is earning a fair living in a chosen field. The franchisee may believe it did not receive sufficient support during the term of the franchise agreement. It may not view being associated with the franchisor's system as a benefit. The franchisor may have increased its fees during the term and as a result, the franchisee may not have been profitable or sufficiently profitable. The franchisee may want to sell additional products and services that are not currently permitted by the franchisor, may want to charge market rates for services the franchisor requires it charge at discounted rates, or it may not want to agree to certain provisions of the then-current franchise agreement.

Once these interests are explored, the mediator can move into the next step in *Getting to Yes*: Invent Options for Mutual Gain. The dispute is less likely to end in settlement if the parties only focus on their essentially binary positions, *i.e.*, the franchisor wants the non-compete to be enforced and the franchisee wants it to be waived. To do this, it is beneficial if the mediator has a background in franchising.

Once the interests are identified and considered, there may be potential win-win options for mutual gain. For example, perhaps the parties can explore the possibility of franchise renewal that addresses both parties' interests. These options may include:

1. Additional franchisor operational support, or marketing at franchisor's expense combined with franchisee's commitments and revenue targets.
2. Temporarily reduce royalties with a later increase to the standard level based on a timeline or upon achievement of revenue targets.
3. Revise certain terms in the standard renewal franchise agreement, such as allowing the franchisee to test new products or services.
4. An extension of the franchise agreement for a term shorter than standard term, with the franchisee having an option to renew.

The next step is for the mediator to encourage the parties to use objective criteria. If the franchisee is underperforming, perhaps a goal is for the franchisee to increase revenue up to the 50th percentile of franchisee revenue outlined in Item 19 of the FDD. These approaches may facilitate a mediated settlement in a non-compete case.

Conclusion

The same analytic framework can be applied to the myriad disputes that arise in the franchise relationship. As demonstrated above, a successful mediation will begin with the people being separated from the problem. Then, when each party's interests are fully explored, the options for mutual gain expand, with objective criteria helping to guide the process. Following these principles can lead to a greater likelihood that the parties will be able to reach common ground and, ultimately, resolve their dispute. ■

Franchising in the Gulf Cooperation Council Region

By Babette Märzheuser-Wood, Dentons

Many US franchisors will have one of their first international franchise opportunities in the Middle East. The GCC or Gulf Cooperation Council comprises six countries, namely, the Kingdom of Saudi Arabia, the United Arab Emirates, Kuwait, Bahrain, the Sultanate of Oman, and Qatar. The only GCC country that has enacted a franchise law is the Kingdom of Saudi Arabia. The other GCC countries have historically applied (and continue to apply) commercial agency laws to franchise agreements. The application varies from liberal (in the case of Oman) to strict (in the case of Kuwait). Commercial agents have enjoyed a high level of protection, particularly as concerns protection against termination in the Middle East.

Overviews of the commercial agency laws in the United Arab Emirates, Qatar, Oman, Kuwait, and Bahrain, and Saudia Arabia's franchise law follow.

United Arab Emirates

Under the United Arab Emirates ("UAE") laws, business relationships between a principal and a local distributor, franchisee, or agent, which relate to the distribution of the principal's goods and services in the UAE in exchange for a commission or profit, are classified as "commercial agencies." On that basis, despite the fact that a distributorship, agency, and franchise differ in many ways, all of these arrangements would fall under the general principles of "commercial agencies" under the Federal Law No. 3 of 2022 on Commercial Agencies. In practice, in the UAE both registered and unregistered agencies exist, but by law, only registered agencies are valid. Historically, unregistered agencies were recognized as valid and treated as governed by the general commercial and civil laws and not by the commercial agencies laws. Therefore, agency registration is beneficial to the franchisee as it secures for the franchisee the protections available under the commercial agencies laws.

In order for a commercial agency arrangement to be registered in the UAE, the commercial agent must be (i) a UAE national or a UAE legal entity that is majority owned by UAE nationals, (ii) the contract must be exclusive either in respect of one Emirate or the entire country, and (iii) the application for registration must be accompanied by a copy of the agency (or franchise) contract notarized and authenticated by the authorities. This requires also that the commercial agency agreement be translated to Arabic. As a practical matter, franchisors should resist notarization and translation to prevent registration. However, even where these formalities have not been observed, it may at times be possible for the franchisee to approach the local UAE courts to seek an order for registration of its agency.

Companies that do not meet these requirements may operate as unregistered agents. The main benefits for agents/franchisees of registration of the franchise agreement with the Ministry of Economy and Tourism are (i) application of the provisions of the Agency Law overriding certain express provisions of the franchise agreement, (ii) entitlement of the agent/franchisee to commission on all sales in the exclusive territory, (iii) de-facto exclusivity in that no person other than the registered agent/franchisee can import the products into the registered territory (however under the Federal Law No. 3 of 2022 the principal may seek permission for such import on a temporary basis, which can be useful if a dispute with an agent around termination is pending), and (iv) the termination or non-renewal of the agreement becomes difficult as the notice period shall generally be no less than one year. Notably, the Federal Law No. 3 of 2022 relaxed the termination rules, as the previous commercial agency law permitted early termination only for "material reason," while currently the parties are free to agree on termination grounds in their contract.

Finally, the registered person is in a strong position with respect to claiming compensation upon termination or non-renewal. The only real benefit of registration from the foreign franchisor's

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perspective is that, once registered, the commercial agent is able to control parallel imports of the relevant products into its registered territory, given the right to block those products.

Qatar

There is no specific franchise law in Qatar. However, Qatar has enacted a Commercial Agents Law No 8 of 2002 (the" Commercial Agents Law") that protects registered commercial agents in the event of termination or non-renewal of their contract. In order for an agreement to qualify as an agency agreement governed by the Commercial Agents Law, several criteria need to be met, namely (i) the agent shall be a Qatari national or a company owned by Qatari nationals, (ii) exclusivity of the agent, and (iii) the agent acts on behalf of the principal and not on its own accord.

The general principle under Qatari Civil Law No. 22 of 2004 is that each contract must be performed in accordance with its contents. Qatari courts will, in principle, respect the contracting parties' intent as set out in a contract. Contracting parties are therefore free to enter into any contractual terms they choose, including the choice of a foreign governing law. However, this general principle is subject to the requirements of public policy and morality and to certain mandatory legislative provisions which apply regardless of any contrary provisions in the contract. Public policy and morals include certain fundamental Qatari religious, ethical, and moral values.

Having said that, there is a risk that at least in certain cases a franchise agreement could be qualified and registered as an agency agreement if (i) it is exclusive, and (ii) the franchisee is Qatari owned. Therefore, it is advisable, if the aim is to avoid being construed as an agency agreement, that the franchise agreement is non-exclusive and expressly states that it shall not be interpreted as a commercial agency or distributorship agreement and prohibits its registration. Nevertheless, one cannot entirely exclude that in the event of a dispute the court would requalify a franchise agreement as an agency agreement. If it is decided by the courts that the agreement is an exclusive agency, there are material risks for the franchisor upon termination or non-renewal. In those cases, the Qatari agents may be entitled to compensation (exceeding what is agreed in the contract) and in some cases the authorities may block importation of goods or services that were covered by the agency contract, which will mean the principal's goods and services will not be available within Qatar's territory.

Oman

There is no specific law on franchise arrangements in Oman. Agency/distribution is governed by Royal Decree 26 of 1977 as amended ("Agency Law"). The Agency Law defines commercial agency as: "Any agreement through which a merchant or a commercial company in the Sultanate is assigned to promote or distribute the products or services of a foreign person or entity in consideration for profit or commission." The common view is that franchise agreements fall within the definition of agency agreements.

Under the Agency Law, an agency agreement has to be registered with the Ministry of Commerce, Industry and Investment Promotion and there are serious consequences for lack of such registration. Local courts will not enforce an agency agreement that has not been registered. Also, there is a risk that a foreign arbitral award issued in relation to an unregistered agency agreement will not be enforceable in Oman. Therefore, currently, it seems advisable to register a franchise agreement in Oman. Importantly, the original wording of the Agency Law was amended so that several statutory protections for registered agents were removed. In particular, termination or non-renewal is no longer limited to cases where the agent committed a material breach. The prohibition against direct sales of a foreign principal's goods or services or sale through an intermediary other than the registered agent has also been removed. Furthermore, the agent no longer has a right under law to claim compensation for termination of an agreement that has been registered with the Ministry of Commerce, Industry and Investment Promotion. Nevertheless, courts have at times awarded compensation to registered agents when an agency agreement has been terminated without a "valid cause."

Kuwait

In Kuwait, foreign companies can do business only though a locally appointed agent. Kuwait's Decree Law No. 68 of 1980 Concerning the Promulgation of the Commercial Law provides that a non-Kuwaiti national or entity may engage in commercial business in Kuwait only through a Kuwaiti agent or through a local company with Kuwaiti-majority ownership. By way of exemption under Law No. 1 of 2024, effective January 21, 2024, a non-Kuwaiti national or entity may directly establish a branch in Kuwait and engage in commercial business without a Kuwaiti agent. It is yet to be seen how this new regulation will work in practice.

Nevertheless, in the case of a direct franchise agreement with an entity based in Kuwait, the application of local commercial agency laws cannot be avoided. The Commercial Agencies Law No. 13 of 2016 (the "Commercial Agencies Law") provides that only a Kuwaiti corporate entity with no less than 51% Kuwaiti ownership, a Kuwaiti individual, or a group of Kuwaiti individuals, that is registered in the Commercial Register and is licensed to practice the business activity of the commercial agency (which term is defined to include agent, distributor, franchisee, and licensee) may act as, and register in the Commercial Agencies Register as, a commercial agent in Kuwait. This means that the franchise agreement will need to be entered into with a local entity/individual, translated to Arabic (the translation must be officially stamped and approved by the Ministry of Justice), and registered with the relevant authority in Kuwait as a commercial agency agreement.

The Commercial Agencies Law obligates every commercial agent to register the agency agreement with the Commercial Agencies Register at the Ministry of Commerce and Industry, failing which the agreement will not be valid in Kuwait. The Commercial Agencies Law provides that a principal may not terminate or refuse to renew a contract without the agent having committed a material breach thereof; otherwise, the principal is liable to compensate the terminated agent for damages suffered as a result of such termination. It further provides that any agreement to the contrary shall not be valid. Termination for the agent's default is quite strictly construed by the local courts to include only egregious breaches or failures to meet agreed sales quotas. The Commercial Agencies Law provides that Kuwaiti commercial courts have original jurisdiction to finally settle any dispute arising from agreements registered in the Commercial Agency Register, except when there is a duly authorized arbitration agreement.

Bahrain

In Bahrain, there is no standalone franchise law that governs the relationship between a franchisor and a franchisee. There is, however, the Commercial Agency Law No. 10 of 1992, as amended (the "Bahrain Commercial Agency Law"), which provides a framework for commercial agency arrangements in Bahrain. The Bahrain Commercial Agency Law defines commercial agency as "the representation of the principal in commercial sales whether for commission or part of the profit, …. or otherwise in the facilitation of trade."

The definition of commercial agency seems wide enough to capture a number of franchise structures. The registrable commercial agent must be a Bahraini national or a company that is not less than 51% locally owned and has its registered office in Bahrain. The registered commercial agents may be entitled to compensation from the principal if their contract is terminated or not renewed, but they do not have a statutory right to block the importation of products by other persons. Additional difficulty may arise on termination as no new agency may be registered without the consent of the existing agent to cancel its registration. Thus, compensation may have to be paid by franchisors to remove the former franchisee/agent from the register and appoint a new partner.

That being said, it also seems possible for a franchise to operate lawfully outside the commercial agency regime and without registration. There have been instances where courts of Bahrain have distinguished between franchise and agency agreements. For example, in one case the terms of a franchise agreement were measured against the Law of Commerce, the Civil Code, trademark law, and intellectual property laws and not subjected to the Commercial Agency Law.

Treating a franchise agreement for Bahrain as an agency agreement and applying the Commercial Agencies Law is favorable to the franchisee. If the desire is to avoid the law's application, it should be expressly stipulated in the franchise agreement that the Commercial Agencies Law does not apply and that the franchise agreement will not be registered. If the agreement is not registered, in principle, the franchisee cannot invoke the provisions of the Commercial Agencies Law. Notwithstanding the above, it needs to be kept in mind that the qualification and interpretation of the relationship between the parties is ultimately subject to the discretion of the courts. Therefore, even if the parties state that the franchise agreement shall not be treated as an agency agreement, it cannot be entirely excluded that the courts may decide otherwise and apply the Commercial Agencies Law to the franchise agreement. Also, even where the franchisee has not secured a registered agency, compensation may be payable to them upon termination based on general principles of local law, which are also viewed as mandatory by the local courts.

Despite a foreign jurisdiction clause, there is a practical risk that the local courts will apply local Bahraini law and permit disputes to be heard in the local courts if the agent/franchisee

is a local company. The Bahrain Cassation Court has repeatedly taken the view that the courts of Bahrain have jurisdiction where one of the parties is Bahraini or resides in Bahrain. Arbitration agreements may be preferrable as they are typically upheld.

Saudi Arabia

In Saudi Arabia, franchising is governed by Franchise Law introduced by way of Royal Decree No. M/22 dated 9/2/1441H, as amended (the "Franchise Law"), and the accompanying Implementing Regulations approved by Ministerial Decision No. 00594/1441 ("Implementing Regulations"). The Implementing Regulations supplement the Franchise Law. Franchise agreements executed in Saudi Arabia need to comply with the Franchise Law, which is mandatory. The Franchise Law and the local Law of Commercial Agencies are mutually exclusive and the Franchise Law states that an agreement subject to the Law of Commercial Agencies shall not qualify as a franchise agreement.

The Franchise Law in Saudi Arabia defines "franchise" as a right granted by the franchisor to the franchisee to run a business under the brand name of the franchisor. To distinguish a franchise from a trademark license, the law requires the transfer of technical expertise and certain specifications to be made as to the manner of operation. A franchise fee is not required. Therefore, "franchise" is defined broadly.

The important provisions of the Franchise Law include:

- Existing Model: The franchisor may offer franchises only after the franchise business model has been tested for a period of at least one year in at least two different pilot locations or by at least two persons (one of which may be the franchisor).
- Disclosure Requirements: Under the Franchise Law, the franchisor must provide the franchisee with a disclosure document not later than 14 days prior to the earlier of: (i) concluding the franchise agreement, or (ii) the date of any payment made by the franchisee in relation to the franchise. The disclosure document must (i) be in Arabic, and if it is drafted in another language then a certified translation to Arabic needs to be provided, (ii) be clear and precise, and (iii) include, as an appendix, the form of franchise agreement. It also needs to contain specific disclosure items, which are listed in the Implementing Regulations. If there is material change to the disclosure document after it was delivered to the franchisee, the franchisor must provide a new disclosure document. Re-disclosure will also generally be required prior to a variation to the existing franchise agreement. If the franchisor breaches the disclosure or registration obligations, the franchisee may terminate the franchise agreement or claim damages from the franchisor without terminating the franchise agreement. Additionally, the franchisor may be fined.
- The Franchise Agreement: The franchise agreement must have certain minimum content. However, any professionally drafted franchise agreement will contain the required provisions. They include a requirement that the agreement must determine the rights granted to the franchisee, the training obligations of the franchisor, details of the product supply, confidentiality obligations, financial terms, and any territorial protections. The Saudi Arabian Franchise Law limits the grounds for termination to the instances listed in the Franchise Law. Non-renewal equally is permitted only in cases listed in the Franchise Law. As regards the formal requirements, the franchise agreement needs to be in writing and drafted in Arabic. If it is drafted in another language, a certified translation to Arabic is required. The foreign franchisor's signatures should be notarized, apostilled, and attested in Saudi Arabia for the purposes of the registration process.
- Registration: The franchisor must register the signed franchise agreement and the disclosure document with the Monsha'at within 90 days from the date of signing the agreement. It is important to note the franchisor must register or apply to register its trademark in Saudi Arabia before applying to register the franchise agreement and the disclosure document.
- Franchisor's Obligation to Repurchase: If the franchisee terminates the agreement due to franchisor's breach of disclosure and/or registration obligations or if the franchisor terminates or refuses to renew in violation of the Franchise Law, the franchisor must repurchase from the franchisee the material assets used exclusively in the franchised business and compensate the franchisee for any damage it has incurred.
- Disputes, Choice of Law, and Forum: The Franchise Law does not require a franchise

agreement to be governed by local law, nor that disputes are resolved by local courts. Therefore, franchise agreements can be governed by US law; nevertheless, their terms and conditions need to be in compliance with the Franchise Law, and the franchisor will need to comply with disclosure and registration requirements. The Franchise Law expressly permits that disputes may be settled by alternative means of dispute resolution such as arbitration, mediation, and conciliation. Enforcing a foreign judgment in Saudi Arabia requires "reciprocity of enforcement," which is usually secured by way of international treaties between Saudi Arabia and other countries. Foreign judgments are generally not automatically enforceable; they must be recognized by Saudi courts through an exequatur process, which involves verifying that the judgment does not contravene Sharia law, Saudi public policy, or the principles of reciprocity. The enforcement of foreign arbitration awards is facilitated by Saudi Arabia's accession to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

Many thanks to my colleague Agniezka Nagorska-Kordeczka for her help with writing this Article. ■

Message from the Chair

Continued from page 1

on a familiar issue or an entirely new topic, they can help with ideas — and even potential co-authors. Writing not only sharpens our thinking, it also opens the door to speaking at future Annual Meetings.

- **Buy and contribute** to our book publications. Publications Chair Dan Oates (Dan.Oates@millernash.com) welcomes ideas and contributions. We have a library of outstanding resources – including *Franchise Relationship Laws*, *Representing Franchisees*, *Covenants Against Competition in Franchise Agreements* (4th Ed.), and *International Franchise Sales Laws* (3rd Ed.).

The Forum remains one of the best parts of practicing franchise law – because of the people. Our members' generosity, collegiality, and sense of humor make this community special. Please keep getting involved and encourage your colleagues to do the same.

Thank you for being a member of the Forum on Franchising and for making it such a welcoming, engaging, and fun group. Please keep sharing your ideas – and if your post-conference to-do list looks anything like mine, maybe we will start a support group. (First meeting: right after we answer all those emails.) My email is Jason.Adler@Servicemaster.com. ■

What Does AI Have to Do With Your Pricing? Cautionary Antitrust Considerations

By Abby L. Risner, UB Greensfelder LLP

We hear about the boundless possibilities offered by Artificial Intelligence ("AI"). But for franchisors and franchisees alike, AI tools in franchise systems present, among other considerations, potential antitrust risks associated with the use of generative AI ("GenAI") in setting prices, usually through use of algorithmic pricing. Use of such tools sits at the intersection of the rapidly developing world of AI and the government's increased antitrust scrutiny.

Perhaps a trap for the unknowing, the following hypothetical presents a potential scenario: Your company decides it wants to take advantage of a new GenAI pricing software option for determining how to price products or services, and with it the potential for decreased reliance on humans (including errors and costs associated with personnel), better opportunity for real time price adjustments, increased integration of available data, and established algorithmic offerings from vendors that automatically recommend price changes.

Yet with this potential opportunity comes at least two critical variables that may have antitrust implications:

1. What happens to the confidential data that you input?
2. What non-public data does the algorithm use?

Franchise systems considering the use of industry information, pricing software, and GenAI ought to carefully explore what antitrust risks exist and how those risks may increase when using common GenAI pricing tools.

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Antitrust Laws to Consider

The Sherman Act, Section 1, prohibits collusion in the form of price fixing: "[e]very contract, combination in the form of trust or otherwise, or conspiracy" that unreasonably restrains trade. 15 U.S.C. § 1; *NCAA v. Bd. of Regents of Univ. of Oklahoma*, 468 U.S. 85, 98 (1984). Under the Sherman Act, competitors may not join their independent decision-making power to fix or establish prices—in other words, they cannot eliminate their independence in setting prices. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223-24 & n.59 (1940); *Am. Needle, Inc. v. NFL*, 560 U.S. 183, 186, 195 (2010). This presents risks associated with both horizontal (competitors at the same level) and vertical (different levels in supply chain, *e.g.*, manufacturer and retailer) price-fixing allegations. Horizontal price fixing among competitors is generally per se unlawful. *FTC v. Superior Ct. Trial Lawyers Ass'n*, 493 U.S. 411, 434 (1990); *Socony-Vacuum*, 310 U.S. at 218, 224 n.59. Vertical agreements, however, are analyzed under the rule of reason. Agreements to conspire that contain both vertical and horizontal elements are referred to as "hub and spoke" agreements and are generally analyzed under the rule of reason.

Under the standards set by the Supreme Court of the United States, Section 1 claims focus on two elements: (1) a "contract, combination, or conspiracy"; (2) that "unreasonably restrains trade." *Am. Needle*, 560 U.S. at 186, 190 & 195. Perhaps most pertinent to the use of GenAI in pricing is the first element: an agreement between two or more competitors—concerted action or the joining together of "independent centers" of decision-making. *Id.* Such an illegal "agreement" can occur through a tacit or explicit agreement. *Meyer v. Kalanick*, 174 F. Supp. 3d 817, 825 (S.D.N.Y. 2016) ("Sophisticated conspirators often reach their agreements as much by the wink and the nod as by explicit agreement, and the implicit agreement may be far more potent, and sinister, just by virtue of being implicit.").

Recent challenges by both private litigants and the government to the use of GenAI for pricing highlight that "the machinery employed by a combination for price-fixing is immaterial." *Socony-Vacuum Oil Co.*, 310 U.S. at 223. Instead, the below discussion shows that regulators, government agencies, and litigants focus on whether the alleged arrangement "joins together separate decisionmakers" that "deprive[]

the marketplace of independent centers of decision making." *Am. Needle*, 560 U.S. at 195.

Antitrust Laws Apply to GenAI Pricing Tools

Although antitrust laws have long condemned concerted action in setting pricing, the use of GenAI through an algorithm brings new considerations. Courts now face questions about whether—and, more importantly, in what circumstances—competitors' common use of an algorithm amounts to an "agreement."

The most closely watched litigation pertaining to price fixing claims arising out of algorithms is RealPage Inc.'s alleged use of data, including non-public data, to estimate demand for housing and generate rent prices for landlords. RealPage now faces a series of suits and claims brought by the DOJ, state attorneys general, and private litigants (with the DOJ Antitrust Division filing statements of interest in the private litigation with several important takeaways).

The DOJ argues that RealPage's delegation of decision making to a common entity (such as the algorithm provider) affects actual or potential competition, even without any additional subsequent agreement or coordination among the competitors. It argues that this kind of delegation represents the joining together of separate actors with separate economic interests characteristic of the concerted action covered by the Sherman Act. *See* Statement of Interest of the United States, U.S. Dep't of Justice Antitrust Div., https://www.justice.gov/d9/2023-11/418053a.pdf (Nov. 15, 2023) (citing *Relevant Sports, LLC v. United States Soccer Fed'n, Inc.*, 61 F.4th 299, 309 (2d Cir. 2023) (concluding that allegations that competing entities "have 'surrendered [their] freedom of action . . . and agreed to abide by the will of the association[]'" are "enough" for concerted action" (*citing Anderson v. Shipowners' Ass'n of Pac. Coast*, 272 U.S. 359, 364-65 (1926))).

In *RealPage*, the district court denied RealPage's motion to dismiss, ruling that because the Sherman Act "proscribes only concerted action, not independent conduct," the Complaint plausibly alleged that each RealPage RMS client defendant "began prioritizing raising rent prices over decreasing vacancy rates" and that "each RMS Client Defendant provided RealPage its proprietary commercial data, knowing that RealPage would require the same from its horizontal competitors and use all of that data to recommend rental prices to its competitors." *In re RealPage, Inc., Rental Software Antitrust Litig. (No. II)*, 709 F. Supp. 3d 478, 510 (M.D. Tenn. 2023).

Explaining the rationale for denying the motion to dismiss, the court quoted Maureen Ohlhausen, a former Chair of the FTC:

> Everywhere the word 'algorithm' appears, please just insert the words 'a guy named Bob.' Is it ok for a guy named Bob to collect confidential price strategy information from all the participants in a market, and then tell everybody how they should price? If it isn't ok for a guy named Bob to do it, then it probably isn't ok for an algorithm to do it either.

Id. at *17.

Another federal court denied a motion to dismiss in a similar case. That court concluded that the plaintiff alleged plausible allegations that competitors entered into an agreement to provide commercially sensitive data to a vendor, knowing the vendor was collecting similar data from competitors and would use it to generate rental rate recommendations to clients. *Duffy v. Yardi Sys.*, No. 2:23-cv-01391, 2024 U.S. Dist. LEXIS 219629, at *11-12 (W.D. Wash. Dec. 4, 2024); *Duffy v. Yardi Sys., Inc.*, No. 2:23-CV-01391, 2024 WL 4980771, at *1 (W.D. Wash. Dec. 4, 2024); *Duffy v. Yardi Sys., Inc.*, No. 2:23-CV-01391, 2024 WL 5049074, at *3 (W.D. Wash. Dec. 5, 2024).

In contrast, a different court dismissed a similar case brought against a software company providing services to hotel industry clients operating on the Las Vegas Strip. *Gibson v. Cendyn Grp., LLC*, No. 2:23-CV-00140, 2024 WL 2060260, at *3 (D. Nev. May 8, 2024) (involving both a hub and spoke claim and a vertical claim). The case alleged that the hotels artificially inflated the price of hotel rooms after all agreeing to use software marketed by the same software company. The court dismissed the case after concluding that the plaintiffs failed to "plausibly allege a tacit agreement between Defendants or a restraint on trade in part because Hotel Defendants are not required to and often do not accept the pricing recommendations generated." *Id.* at *1.

The court considered several factors in rejecting the claims. The hotel defendants did not start using the software around the same time, and the hotel defendants did not agree to be bound by the pricing recommendations, much less agree to charge the same prices. *Id.* at *3-4. Critically, the court noted that the plaintiff did not allege that the hotel competitors exchanged non-public information, stating that "consulting public sources to see your competitors' rates in reaching decisions about how to price hotel rooms does not violate the Sherman Act." *Id.* at *4. The court also rejected the theory that unlawful collusion occurs simply because the algorithms get "better at predicting optimal hotel room pricing with the benefit of information

provided by each customer." *Id.* at *6. *See also Gibson v. MGM Resorts Int'l*, No. 223CV00140MMDDJA, 2023 WL 7025996, at *6 (D. Nev. Oct. 24, 2023) (granting motion to dismiss original complaint because it failed to contain any allegation that, even if same algorithmic pricing software were used, that "Hotel Operators exchange nonpublic information with each other through their use of that same software").

The critical distinction in the outcome of these cases: the courts focused on the Sherman Act's "agreement" element and evaluated whether the facts included "allegations of the exchange of otherwise confidential information between competitors through the algorithm." *Gibson v. Cendyn Grp., LLC*, No. 2:23-CV-00140-MMD-DJA, 2024 WL 2060260, at *4 (D. Nev. May 8, 2024); *see also In re RealPage, Inc., Rental Software Antitrust Litig. (No. II)*, 709 F. Supp. 3d 478, 512 (M.D. Tenn. 2023) (contrasting allegations "that RealPage's revenue management software inputs a melting pot of confidential competitor information through its algorithm and spits out price recommendations based on that private competitor data"). In other words, the courts focused on the use and exchange of confidential or proprietary data in connection with the common source or vendor—the prices were public, but the apartment leasing data was not generally public.

Of course, these issues remain pending in the courts and subject to further developments. Additionally, in August 2024, the DOJ and several state attorneys general filed their own case against RealPage based on the activity discussed above. As another example, the DOJ and FTC filed a Statement of Interest in another case pending in New Jersey involving casino hotels using pricing algorithms, in which the court then granted a motion to dismiss. *See* U.S. Dep't of Justice, *Statement of Interest of the United States, Cornish-Adebiyi v. Caesars Enter., Inc.*, https://www.justice.gov/opa/media/1345721/dl?inline; *Cornish-Adebiyi v. Caesars Ent., Inc.*, No. 1:23-CV-02536, 2024 WL 4356188, at *1 (D.N.J. Sept. 30, 2024).

Finally, companies should monitor legislative and regulatory developments. For example, in 2024, Senator Amy Klobuchar (D-MN) introduced the Preventing Algorithmic Collusion Act of 2024 (S. 3686, 118th Cong.), which has now been introduced again (S. 232, 119th Cong. (2025)). Additionally, the former Chair of the FTC announced priorities to regulate AI and enforce antitrust pricing laws—a direction that remains unknown under the current Administration—and personnel at the DOJ and FTC have written and spoken on the need to ensure AI does not result in fixing prices. *See, e.g.*, FTC Staff, *Price Fixing By Algorithm is Still Price Fixing*, Fed. Trade Comm'n (Mar. 1, 2024), https://www.ftc.gov/business-guidance/blog/2024/03/price-fixing-algorithm-still-price-fixing.

Best Practices on Evaluating the Use of GenAI for Pricing or Pricing Algorithms

The following outlines the key considerations highlighted by the court decisions issued to date and the statements issued by the government on the use of GenAI or pricing algorithms for setting prices:

- *Are competitors using the same algorithm?* Based on the decisions rendered to date, the use of the same algorithm vendor or service by competitors may not necessarily amount to an agreement, or it may do so only in limited circumstances depending on how competitors use the service. Violations require an allegation of a "conscious commitment to a common scheme designed to achieve an unlawful objective." *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 764 (1984). Companies should assess whether potential competitors utilize the same algorithm and evaluate integration of their own customization and preferences to the algorithm's design to ensure that their use does not amount to a simplistic cookie-cutter of competitor use.
- *Will the algorithm incorporate non-public data? If so, will the algorithm share it outside of your company, either directly or indirectly through learning? In other words, will your non-public data be shared with the algorithm in a way that potential competitors will use it?* RealPage allegedly incorporated customers' non-public data and then integrated that data into algorithms used by competitors. On the other hand, the *MGM Resorts* court held that the lack of allegations of sharing non-public information weighed against an "agreement" that could amount to price fixing. *Gibson v. MGM Resorts Int'l*, No. 223CV00140MMDDJA, 2023 WL 7025996 (D. Nev. Oct. 24, 2023). Avoid—and construct any vendor contracts to avoid—sharing your confidential information beyond your own environment, and use of the algorithm in your own environment. Include provisions that limit a vendor's use of your non-public data beyond your own environment and address potential liability for any violation.

- *Consider the reverse: Will the algorithm you access include others' non-public data?* The DOJ phrased the inquiry this way: are you "knowingly combining [your] sensitive, nonpublic pricing and supply information in an algorithm that [you] rely upon in making pricing decisions, with the knowledge and expectation that the other competitors will do the same"? *See* U.S. Dep't of Justice, *Memorandum of Law in Support of the Statement of Interest of the United States: In Re: RealPage, Rental Software Antitrust Litigation (No. II)*, at 15, https://www.justice.gov/d9/2023-11/418053a.pdf. Ask questions to potential vendors about whether the algorithm incorporates any confidential, non-public information. Keep in mind that generally, "[t]here is nothing unreasonable about consulting public sources to determine how to price your product." *Gibson*, 2024 WL 2060260, at *5. Consider incorporating terms in any vendor agreement to prohibit the incorporation of non-public data into the algorithm.
- *Avoid any mandatory adoption of pricing recommendations.* In the private *RealPage* litigation, the complaint alleges that RealPage developed the technology to ensure the landlords actually used the "recommendations" from the program and put pressure on them to implement the recommended prices, which they allegedly did around 80-90% of the time. *In re RealPage, Inc., Rental Software Antitrust Litig. (No. II)*, 709 F. Supp. 3d 478, 493 (M.D. Tenn. 2023). RealPage allegedly required clients to submit requests to the corporate office if they wanted to deviate from the recommended prices, and they tracked who requested deviations. Do not surrender independent decision-making and become beholden to the algorithm's recommendation; do not let the business treat use of GenAI as a full outsource; and be willing to override—and in fact demonstrate a practice of frequently overriding—the recommendations.

Although many questions related to using GenAI to set prices remain unanswered, the litigation alleging "algorithmic price fixing" provides warning of the risks of competitors feeding non-public data into the same system as a tool to determine pricing. Franchisors and franchisees should be aware of the potential risks and evaluate any GenAI pricing options with the above factors in mind. This developing area of the law will turn not only on the specific facts of how potential competitors use GenAI pricing algorithms, but also on continued evaluation of the legal issues in the courts and potential legislation. ■

Message from the Editor-in-Chief

By Justin L. Sallis, Lathrop GPM LLP

Another wonderful Annual Forum on Franchising is in the books. I left the meeting feeling informed, rejuvenated, appreciative to have such great colleagues, and a little dizzy from a couple of theme park rides. With the exception of the latter, I trust that those of you who attended feel the same. For that, great thanks to Caroline Fichter and Dan Oates, the Meeting's co-chairs, the planning committee, and the many authors and speakers!

As Jason mentioned in the Chair's message, work to plan the next Annual Forum on Franchising has already begun. Between now and then, there are several ways to get and stay involved with the Forum. Among other things, consider writing for the *The Franchise Lawyer* or *The Franchise Law Journal*; peruse the Forum website's vast franchise law resources; register for an upcoming webinar; look into joining a committee, division or caucus; or simply reach out to a Forum colleague for a coffee. Your enthusiasm, engagement, and contributions keep our terrific community thriving.

Speaking of terrific, this issue of *The Franchise Lawyer* has four excellent articles that are sure to educate readers on various legal considerations in the use of artificial intelligence tools for price setting and franchise sales, franchising in the Gulf Cooperation Council region, and approaching mediation with, maybe, a different mindset. Be the next to contribute to the publication by reaching out to me at Justin.Sallis@Lathropgpm.com! ■

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