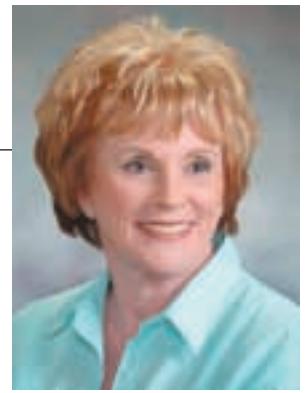


# industry trendsetters



## combining the legal elements of timesharing, franchising & points

### how shell vacations pioneered in creating a new timeshare product

By Marge Lennon

Consider the complexities of registering and selling a timeshare resort in multiple states. Now imagine the regulatory issues involved in franchising a product where every franchisee looks different but must operate under the same rules. Add to this scenario the placement of a points-based timeshare club within the franchise program.

Sound complicated? Yes, it certainly wasn't a walk in the park. To use one of the favorite words of Tracy Sherles, the Shell Vacations executive who envisioned the concept, it was truly a "daunting" experi-

unknown to timeshare developers until Shell Vacations LLC launched its franchising initiative - Shell Vacations Systems - in the spring of 2004. By press time in June 2005, two resorts had been affiliated with the program, maintaining the company's goal of three per year and focusing on controlled growth.

#### The Evolution of a New Idea

Reminisces Richard Stasica, Associate General Counsel for Shell Vacations LLC, headquartered in Northbrook, Illinois, "The origin of our franchising program

Tracy Sherles, who created the company's points-based vacation club and Richard Stasica to meet with their outside franchising counsel and timesharing counsel at DLA Piper to discuss the feasibility of creating such a program and to determine what obstacles had to be overcome.

"We quickly discovered that the biggest hurdle before presenting the concept to the industry was to see how much actual demand there would be," said Sherles. "We knew there had been many calls, but we didn't know exactly who our ideal customer would be: existing timeshare developers, hotel conversions, new timeshare entrants or an association with significant inventory. Before moving forward, we had to prepare a Uniform Franchise Offering Circular (UFOC), which is required under franchise law."

One of the aspects of the Shell franchise offering that may initially appear different than a typical fast food franchise is that in the food model the franchisee desires to look substantially like all the other units in the chain. In the Shell Vacations' model, the franchisee wants to be part of a successful system but also wants to maintain the unique feel and identity of their resort. Thus one Shell Vacations Systems franchise resort may appear significantly different from the other. However, each franchisee, no matter what type of resort they have, will end up selling Shell Vacations points identical to a consumer as points sold by Shell or another franchisee.

Their challenge was to ensure that Shell could first balance the interest of the potential franchisee, (generally entrepreneurial in spirit) allowing them to maintain their flexibility and operate their business themselves. But the nature of franchising

*"We quickly discovered that the biggest hurdle before presenting the concept to the industry was to see how much actual demand there would be"*

ence. The barriers to entry into this brave new world were daunting to say the least.

The final merging of timeshare and franchise laws took place as the result of a company that stayed its course once its destination was set and traveled down a path where no one had gone before. In the process, these pioneers created quite an intellectual exercise for those involved in this effort.

While franchising as a discipline is familiar to hoteliers, it was relatively

dates back to the creation of the Shell Vacations Club (SVC) in 1999. Our Club was intentionally created in a modular system to allow for the addition of component sites. Shortly after it was formed, single site developers began asking how they could become a component site within one of our regional clubs and plug into our system. After hearing this question frequently, the idea of franchising was born at the end of October 2003."

The next step was for SVC President

requires a consistency of product and services, something Shell's Club members and purchasers would expect. Overcoming these issues has been their greatest hurdle.

Adds Stasica, "For the UFOC, we had to create a model that would be the starting point for any franchisee, no matter the nature of their property. Our UFOC was created and finalized before the ARDA convention in Las Vegas in May 2004. As the UFOC took over four months to prepare and was over 350 pages, it became obvious it would take time for potential franchisees to get comfortable with both the general concept and the particulars of the franchise offering."

the tools to accomplish this.

Malone states, "We knew the interest was not for a franchisee to simply use our logos and pay a royalty. We knew the value to a franchisee would be to be part of our system and to benefit from the infrastructure we have built."

The entire point of a points-based club is that points in the club are supported by real estate. Backing up the points are thousands of room nights at various facilities. To make this happen, legally, they must subject the resort to local condominium acts and then transfer the interest in the real estate to a not-for-profit entity which issues the points.

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Enter Joe Malone and Franklin Khedouri, Vice Presidents with Shell Vacations Systems and long-time industry executives. Their job was to explain how the SVC system is organized and help the prospective franchisee decide if they are comfortable with all aspects of the business.

It is important to understand that Shell Vacations is not franchising its brand in the traditional sense; instead, they are franchising their Club system. Franchisees sell exactly what Shell sells - Shell Vacations Club points. Their product is converted to points in the same way as Shell's own resorts and sold using the same tools. The franchisee sells its own inventory and runs its own sales and marketing. Shell Vacations gives them

The complicated part of this is how the franchisee participates in the program and transfers their real estate into the independent entity, providing a block of points they can sell. The consumer who buys from a franchisee ends up with the same points as someone who buys from a SVC property, making it seamless from their perspective.

#### **State Registration**

Timeshare developers and marketing professionals understand that state registrations are required to sell their product. As the Shell Vacations Club was created as a modular, regional system, the geographic location of any franchisee will therefore dictate the regional club into which it is placed. The

Salado Creek Villas Resort in San Antonio became an additional component site to the company's existing Shell Owners Club - Southwest. The Southwest Club was previously registered in Texas and simply needed to be amended to include the new component site. Salado Creek was the first SVS franchisee and was affiliated with Shell Vacations Systems in March of 2005. The second SVS franchisee, affiliated in June 2005, was Crotched Mountain Resort & Spa in New Hampshire. This resort will be the first resort in a completely new home club. Part of Stasica's role at Shell Vacations is the registration of the company's regional clubs with state regulatory authorities. As each franchisee is affiliated, he then begins the process of amending the registrations of the regional clubs to include the new component site.

#### **Chicago Title Provides Point Certification**

Chicago Title is a required vendor for SVS franchisees, backing up the points with real estate and thus providing a point certification. With so many state regulators trying to protect the consumers, the certification issued to members from Chicago Title provides a meaningful benefit. Chicago Title's involvement is key because it provides an independent third party to ensure that all points are correctly tracked. This gives the franchisee and their lender significant confidence as they are going into the deal.

#### **Franchise Attorneys Facilitate The Process**

"In bringing the franchisees to the table," says Stasica, "we initially thought they would require a timeshare attorney to assist them through the documents. What we learned was that it is more important for the franchisee to have an attorney familiar with franchise programs than anything else. We found that what can appear onerous to a single-site franchisee might seem common to an individual familiar with typical language of franchise programs. While we can explain to a potential franchisee the reasons we, as a franchisor, need certain language, it is much easier for someone who has negotiated franchises before to understand the needs of a franchisor."

"To help us operate as a franchisor in the new universe of a timeshare franchise program," continues Stasica, a University of Notre Dame Law school graduate, "we have relied on the expertise of our franchise attorneys, as well as our timeshare attorneys and others at various firms in the industry."

"As a franchise attorney for 34 years," says Allen Ginsburg of DLA Piper, "this was one of the most fascinating and intel-

llectually challenging legal things I've ever done. With so many moving pieces, it took issues to a different level of complexity. We went through a lot of what-ifs, flow charts, and diagrams before we were finished. But in the yearlong 'invention' process we traveled down paths where no one had gone before. Adding the points issue made it much more complicated."

He continues, "From the franchise regulatory side, the FTC mandates the delivery of an offering circular which must be given to every prospective franchisee and some states may have registration or disclosure rules."

### Entering Unknown Territory

Creating a new concept that has never been tested can be quite interesting for all involved. As Stasica says, "When you work with a franchise group with the expertise of DLA Piper's group, you often expect them to have seen everything. Seeing how unusual this offering was for them made us grasp how unique our program is in the franchise world. It has been challenging, but exciting to be in such uncharted waters."

Adds Sherles, "Because this unique franchise offering is new and untested, we are planning to diligently oversee all of the processes to ensure that the franchisees have the greatest prospect for a successful venture. Shell is committed to working

closely with franchisees to understand how this new business to business venture can be maximized."

Another risk Shell had to become comfortable with was the liability created by a franchising program. Stasica states, "One of the biggest fears for any potential franchisor to overcome when entering the franchise world is the potential for vicarious liability for the actions of its franchisees. Particularly in an industry like ours where the sales staff is compensated so heavily by commissions, the risk of misrepresentation is high. A SVS franchisee is no longer selling their stand-alone resort and is now representing our product, featuring their resort as a component site. There is no way to completely eliminate this risk, but we tried to creatively minimize the risk. In our franchise documents, we have the right to mystery shop the franchisees, and review any of their marketing materials. We also created a compliance rebate whereby the franchisee can receive back a portion of their royalty for meeting a list of goals we created, such as achieving certain scores on mystery shopping visits, resolution of any consumer complaints and other similar indicators of a compliance-driven company. This way there is an incentive to the franchisee for compliance and not simply deterrents for non-compliance."

Another benefit to the newer franchisee is that the system will no longer be hypothetical but actually in full operation by the first two franchises. It is interesting to note that a year after the SVS offering was finalized, a competitive offering had been launched. And they thought Ray Kroc (McDonald's founder) and Kemmons Wilson (founder of Holiday Inns) were crazy!

According to Sheldon Ginsburg, Shell Vacations President and CEO (and brother of Allen Ginsburg), "As we continue to add franchises, we will be weaving a network across North America. We also plan to expand our Club internationally through franchising, beginning with Canada and Mexico. Several current initiatives are moving us in that direction."

Added Sherles, "The attorneys who helped us create the structure of our Club did a superb job of providing the flexibility that would enable us to incorporate the franchising element. They also all provided great insight as we created the franchise program within our existing structure."

Concludes Tracy Sherles, "It is gratifying that we are getting so much interest in participating in the franchise program. This has validated our premise that there is a real value proposition for developers who want to sell their property as part of a sophisticated club system." **D**

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