

## **REVIEWING AND NEGOTIATING FRANCHISE AGREEMENTS, PART 1 & PART 2**

First Run Broadcast: April 8 & 9, 2014

**Live Replay: July, 23 & 24, 2014**

1:00 p.m. E.T./12:00 p.m. C.T./11:00 a.m. M.T./10:00 a.m. P.T. **(60 minutes)**

Franchises seem to guarantee business success for clients. They take a proven national or regional business concept and brand, plant it in local soil, and watch it grow. The challenge for attorneys is to counsel clients about risk – the failure of a substantial number of franchises – and about the substantial costs and restrictions that go into buying and operating a franchise. There are issues of federal and state regulation, and vastly complex disclosure documents and franchise agreements. Working through the mass of information and properly judging risk/reward can be a daunting task. This program will provide you with a real world guide to the framework of franchise law, practical due diligence of franchise opportunities, and reviewing and negotiating the most important provisions of franchise agreements.

### **Day 1 – July 23, 2014:**

- Understand what arrangements are franchises and which are not – and the consequences
- How to read a Franchise Disclosure Document (FDD)
- Relationship of federal/FTC regulations to state regulation
- Counseling clients about realistic franchise expectations
- Phases of franchise review – due diligence, negotiation of agreement, and lease work

### **Day 2 – July 24, 2014:**

- Major terms of franchise agreements and what's truly negotiable/what's not
- Scope of territory, rights within it, and the opportunity to expand
- Understand the layers of fees, royalties and marketing expenses
- Operating standards and covenants – and opportunities for local variance
- Transfer and exit issues when a franchisee wants out

### **Speakers:**

**Harris J. Chernow** is a partner in the Philadelphia office of Chernow Kapustin, LLC, where he has a national franchise, business transactional and real estate practice. He represents franchisees and franchisors in the full range of franchise transactions, including licensing, distribution, corporate structuring, retail development, and dispute resolution. He is a member of the Governing Committee of the ABA's Forum on Franchising and formerly as chair of the forum's Litigation and Dispute Resolution Committee. He is also a contributor to the book "Franchising 101, the Complete Guide to Evaluating, Buying and Growing Your Franchise Business," published by Upstart Publishing Company. Mr. Chernow received his B.S. from Temple University and his J.D. from Temple University School of Law.

**Joel R. Buckberg** is of counsel in Nashville office of Baker, Donelson, Bearman, Caldwell & Berkowitz, P.C., where he has more than 30 years' experience in corporate and business transactions. His practice focuses on corporate and asset transactions and operations, particularly

**PROFESSIONAL EDUCATION BROADCAST NETWORK**

Speaker Contact Information

**REVIEWING AND NEGOTIATING FRANCHISE AGREEMENTS,  
PART 1 & PART 2**

**Harris Chernow**

Chernow Kapustin, LLC – Philadelphia

(215) 659-3600 ext 102

[hchernow@chernowkap.com](mailto:hchernow@chernowkap.com)

**Joel R. Buckberg**

Baker, Donelson, Bearman, Caldwell & Berkowitz, PC - Nashville

(o) (615) 726-5639

[jbuckberg@bakerdonelson.com](mailto:jbuckberg@bakerdonelson.com)

in hospitality, franchising and distribution. He also counsels clients on strategic planning, financing, mergers and acquisitions, system policy and practice development, regulatory compliance and contract system drafting. Prior to joining Baker Donelson, he was executive vice president and deputy general counsel of Cendant Corporation. Mr. Buckberg received his B.S. from Union College, his M.B.A. from Vanderbilt University, and his J.D. from Vanderbilt University School of Law.

**VT Bar Association Continuing Legal Education Registration Form**

Please complete all of the requested information, print this application, and fax with credit info or mail it with payment to: Vermont Bar Association, PO Box 100, Montpelier, VT 05601-0100. Fax: (802) 223-1573 **PLEASE USE ONE REGISTRATION FORM PER PERSON.**

First Name \_\_\_\_\_ Middle Initial \_\_\_\_\_ Last Name \_\_\_\_\_

Firm/Organization \_\_\_\_\_

Address \_\_\_\_\_

City \_\_\_\_\_ State \_\_\_\_\_ ZIP Code \_\_\_\_\_

Phone # \_\_\_\_\_ Fax # \_\_\_\_\_

E-Mail Address \_\_\_\_\_

**Review & Negotiating Franchise Agreements, Part 1  
Teleseminar  
July 23, 2014  
1:00PM - 2:00PM  
1.0 MCLE GENERAL CREDITS**

VBA Members \$75  
Non-VBA Members \$115

**NO REFUNDS AFTER July 16, 2014**

**PAYMENT METHOD:**

Check enclosed (made payable to Vermont Bar Association) Amount: \_\_\_\_\_

Credit Card (American Express, Discover, Visa or Mastercard)

Credit Card # \_\_\_\_\_ Exp. Date \_\_\_\_\_

Cardholder: \_\_\_\_\_

## VT Bar Association Continuing Legal Education Registration Form

Please complete all of the requested information, print this application, and fax with credit info or mail it with payment to: Vermont Bar Association, PO Box 100, Montpelier, VT 05601-0100. Fax: (802) 223-1573 **PLEASE USE ONE REGISTRATION FORM PER PERSON.**

First Name \_\_\_\_\_ Middle Initial \_\_\_\_\_ Last Name \_\_\_\_\_

Firm/Organization \_\_\_\_\_

Address \_\_\_\_\_

City \_\_\_\_\_ State \_\_\_\_\_ ZIP Code \_\_\_\_\_

Phone # \_\_\_\_\_ Fax # \_\_\_\_\_

E-Mail Address \_\_\_\_\_

**Review & Negotiating Franchise Agreements, Part 2  
Teleseminar  
July 24, 2014  
1:00PM - 2:00PM  
1.0 MCLE GENERAL CREDITS**

VBA Members \$75  
Non-VBA Members \$115

**NO REFUNDS AFTER July 17, 2014**

**PAYMENT METHOD:**

Check enclosed (made payable to Vermont Bar Association) Amount: \_\_\_\_\_

Credit Card (American Express, Discover, Visa or Mastercard)

Credit Card # \_\_\_\_\_ Exp. Date \_\_\_\_\_

Cardholder: \_\_\_\_\_



Vermont Bar Association

CERTIFICATE OF ATTENDANCE

Please note: This form is for your records in the event you are audited

Sponsor: Vermont Bar Association

Date: July 23, 2014

Seminar Title: Review & Negotiating Franchise Agreements, Part 1

Location: Teleseminar

Credits: 1.0 MCLE General Credit

Luncheon addresses, business meetings, receptions are not to be included in the computation of credit. This form denotes full attendance. If you arrive late or leave prior to the program ending time, it is your responsibility to adjust CLE hours accordingly.



Vermont Bar Association

CERTIFICATE OF ATTENDANCE

Please note: This form is for your records in the event you are audited

Sponsor: Vermont Bar Association

Date: July 24, 2014

Seminar Title: Review & Negotiating Franchise Agreements, Part 2

Location: Teleseminar

Credits: 1.0 MCLE General Credit

Luncheon addresses, business meetings, receptions are not to be included in the computation of credit. This form denotes full attendance. If you arrive late or leave prior to the program ending time, it is your responsibility to adjust CLE hours accordingly.

# **REVIEWING AND NEGOTIATING FRANCHISE AGREEMENTS, PART 1**

---

**Joel R. Buckberg**

**Baker Donelson Bearman Caldwell & Berkowitz, PC**

**Nashville, TN**

Direct: 615.726.5639

Fax: 615.744.5639

E-mail: [jbuckberg@bakerdonelson.com](mailto:jbuckberg@bakerdonelson.com)

**Harris J. Chernow**

**Chernow Kapustin, LLC**

**Horsham (Philadelphia Area), PA**

Tel: 215-659-3600 ext. 102

Fax: 215-659-3222

Email: [hchernow@chernowkap.com](mailto:hchernow@chernowkap.com)



# Agenda

---

- Understand what arrangements are franchises and which are not – and the consequences
- Counseling clients about realistic franchise expectations
- How to read a Franchise Disclosure Document (FDD)
- Relationship of federal/FTC regulations to state regulation
- Phases of franchise review – due diligence, negotiation of agreement, and lease work

# Origin of Franchising - Lanham Act

---

## Section 5 (15 U.S.C. Sec. 1055)

Where a registered mark or a mark sought to be registered is or may be used legitimately by **related companies**, such use shall inure to the benefit of the registrant or applicant for registration, and such use shall not affect the validity of such mark or of its registration, provided such mark is not used in such manner as to deceive the public..

## Section 45 (15 U.S.C Sec. 1127)

**'related company'** means any person whose use of a mark **is controlled by the owner of the mark** with respect to the nature and quality of the goods or services on or in connection with which the mark is used.



# The Three Bodies of Franchise Law

---

- Federal and state registration / disclosure statutes and regulations governing the offer and sale of franchises
- State 'relationship' laws governing the post-sale relationship
- Federal and state business opportunity laws governing marketing plans without a trademark at their core

# What is a Franchise?

---

- Business format v. product distribution
- FTC:
  - Oral or written continuing commercial relationship
  - Operate under trademarked name or sell trademarked product
  - Either significant assistance in method of operations or significant control over quality of offered goods or services
  - Required payment (\$500 within 6 mos.)



# Required Payment Examples

---

- initial franchise fee;
- advertising assistance;
- equipment and supplies (including such purchases from third parties if the franchisor or its affiliate receives payment as a result of the purchase);
- training;
- promotional literature;
- equipment rental;
- continuing royalties on sales or fixed fees per capita/period

# Required Payment

---

- Excludes bona fide wholesale price for reasonable quantity of inventory.
- Excludes payments for leases and equipment obtained from franchisor if alternative sources of supply are available at competitive prices for comparable items.

# Licensing

---

- Licenser owns all marks, know how, branding
- Licenser gives IP license in exchange for fees.
- Licenser must control licensed goods or services through standards and tests under Lanham Act.
- Licenser cannot retain significant control or offer significant assistance to licensee.
- Licenser cannot offer fee-based services other than bona fide wholesaling of reasonable quantities of inventory.
- Do they depend on you to run the business?

# Licensing

---

Problem states – No marketing plans permitted in:

Alaska, California, Hawaii, Illinois, Iowa\*, Maryland, Minnesota, Nebraska, New York, Oklahoma\*, South Dakota\*, Texas, Wisconsin

\*Unless mark is registered; In IA, OK, SD seller must have \$1M net worth



# Franchisee Concerns – Why Buy a Franchise?

---

- Why shouldn't I do this myself?
- For what do I need them?
- How will you improve my chances for success?
- What does it cost to enter?
- What will I save with you?
- What do I pay over time?
- How much can I make?
- How will you help me?
- What happens when I want to exit the business?
- Numerous questions to ask

# What is a Good Franchise Opportunity?

---

- ROI
- Big \$\$
- Good Track Record
- Growth Potential
- Buying a Job
- Remember: No guaranty!
- Are you the one to determine this?

# **The Phases of Franchisee Representation:**

---

- Counseling the Prospective Franchisee
- Due Diligence – client duty
- Negotiating the Franchise Agreement
- Business and Real Estate/Lease Issues
- Litigation and Arbitration

# Counseling The Franchisee/Franchisor

---

- Understand the client's background
- Know your client's needs/expectations
- Be clear about your role (and limitations)
  - Business v. Legal
- Emphasize your client's need to do his/her own Due Diligence

# Why Franchise? – Pro's

---

- Expand distribution more quickly using capital and energy of other entrepreneurs
- Build scale for national/regional brand
- Leverage intellectual property assets
- SBA Financing for franchisees lowers borrowing costs
- Top line not bottom line focus
- Steady cash flow yields high multiple in private equity and public market valuations



# Why Franchise? - Cons

---



- Disclosure of business plans and methods
- Audited financial statements required
- Loss of operational, day to day control, including retail prices (subject to max and min resale price limits)
- Hard to find like minded people in every location
- Need scalable support systems
- Administrative expense and burdens of compliance
- Limitations on contract rights in some states
- Loss potential from failed franchise beyond consideration received by franchisor
- Risk of vicarious liability for franchisee act or omission
- Lack of direct consumer contact

# Jurisdictional Issues

---

- What State Law Applies?
  - Where is the franchisee's principal place of business located?
  - Where is the franchised business to be located?
  - Where are negotiations held or documents sent/received?

# State Franchise Registration/Disclosure Laws

---

- What is a franchise?
  - marketing plan or
  - Community of Interest
- Does the state law apply?
- Can we test the water before we dive in?
- Does the state provide an exemption/exclusion for the franchisor, the franchisee or the transaction?
- How do we comply?
- When can we make an offer? A sale?



# Regulatory Framework – State Laws

---

- Not fully preempted by federal law - most restrictive (protective) governs
- Franchisor must comply with FTC Rule *and* State Law
- State registration laws require registration *before making an offer "in this state"*

# State Law Franchise Definitions

---

- *Marketing Plan:*
  - Disclosure laws: California, Illinois, Maryland, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington
  - Relationship laws: 14 States
- *Community of Interest*: “a continuing financial interest between franchisor and franchisee in the operation of the franchised business”
  - Disclosure laws: Hawaii, Minnesota
  - Relationship laws: California, Mississippi, Missouri, Nebraska, New Jersey, Rhode Island, Wisconsin

# Federal Regulation

---

- The FTC Franchise Rule (16 CFR 436):
  - Franchisor must create Franchise Disclosure Document (FDD) in prescribed format
  - Requires FDD delivery to a prospective franchisee 14 calendar days before paying a fee or entering into a contract
  - Requires definitive agreement delivery to prospective franchisee 7 calendar days before paying fee due at signing and entering into a contract
  - Protects franchisee's right to make an informed decision without high pressure sales tactics
  - Requires no filing with Federal government

# Concurrent Federal and State Regulation

---

- FTC permits states to have more restrictive regulation on disclosure, pre-sale activities and transaction terms
- Four State Approaches:
  - Rely on FTC Rule – No law
  - Rely on FTC Rule – Provide remedy (Oregon)
  - File a Notice and Pay a Fee to obtain either:
    - Right to offer and sell (IN, MI, SD, WI), or
    - Exemption from Business Opportunity Law (CT, FL, KY, NB, TX, UT)
  - State Review (CA, HI, IL, MD, MN, NY, ND, RI, VA, WA)

All copyrights are owned by their respective owners.

(c) 2011, 2013 Baker Donelson Bearman Caldwell & Berkowitz, PC. All Rights Reserved.

# Offers Unlawful Unless Registered in Review States

---

## California:

- it shall be unlawful for any person to offer or sell any franchise in this state unless the offer of the franchise has been registered (FIL § 311110).

All copyrights are owned by their respective owners.

(c) 2011, 2013 Baker Donelson Bearman Caldwell & Berkowitz, PC. All Rights Reserved.

# What is an Offer to Sell?

---

## California:

- "Offer" or "offer to sell" includes **every attempt to offer to dispose of, or solicitation of an offer to buy,** a franchise or interest in a franchise for value.

All copyrights are owned by their respective owners.

(c) 2011, 2013 Baker Donelson Bearman Caldwell & Berkowitz, PC. All Rights Reserved.

# Regulatory Framework: Franchise Registration/Filing States

---

Pre-Sale FDD Registration or Filing is required in 15 states before offering or selling franchises in the state or to residents of the state:

- California
- Connecticut
- Florida
- Hawaii
- Illinois
- Indiana – notice filing only
- Kentucky
- Maryland
- Michigan – notice filing only
- Minnesota
- Nebraska
- New York
- North Dakota
- Oregon – maintain books and records, deliver FDD only
- Rhode Island
- South Dakota – notice filing only
- Utah
- Virginia
- Washington
- Wisconsin – notice filing only

All copyrights are owned by their respective owners.

(c) 2011, 2013 Baker Donelson Bearman Caldwell & Berkowitz, PC. All Rights Reserved.

# Avoiding franchise disclosure

---

- Defer all fees over \$499 for 6 months
  - Not effective in registration states except Illinois, Rhode Island, South Dakota, Virginia
- Federal Exemptions:
  - Franchisee initial investment, excluding unimproved land franchisor financing, exceeds \$1 million
  - Franchisee or parents and affiliates has been in business 5 years and has net worth over \$5 million
  - 50% or greater owner of franchise has been officer, director, general partner, franchise sales manager or administrator or at least 25% owner of franchisor
  - Oral franchise agreement
  - Not effective in registration states

All copyrights are owned by their respective owners.



# The FDD: READ IT

---

(because your client probably didn't!)

This applies to both  
franchisors and franchisees

# What's In The FDD?

---

- Item 1: The Franchisor and any Parents, Predecessors, and Affiliates
- Item 2: Business Experience
- Item 3: Litigation
- Item 4: Bankruptcy
- Item 5: Initial Fees
- Item 6: Other Fees

# What's In The FDD?

---

- Item 7: Estimated Initial Investment
- Item 8: Restrictions on Sources of Products and Services
- Item 9: Franchisee's Obligations
- Item 10: Financing
- Item 11: Franchisor's Assistance, Advertising, Computer Systems and Training

# What's In The FDD?

---

- Item 12: Territory
- Item 13: Trademarks
- Item 14: Patents, Copyrights and Proprietary Information
- Item 15: Obligation to Participate in the Actual Operation of the Franchised Business
- Item 16: Restrictions on What the Franchisee May Sell

# What's In The FDD?

---

- Item 17: Renewal, Termination, Transfer and Dispute Resolution
- Item 18: Public Figures
- Item 19: Financial Performance Representations (Earnings Claims)
- Item 20: Outlets and Franchisee Information
  - Also includes Franchisee Associations
- Item 21: Financial Statements
- Item 22: Contracts
- Item 23: Receipts – Electronic Disclosure

# What's In The FDD?

---

- EXHIBITS – sample listing
  - Franchise Agreement
  - State Riders/Amendments
  - Development Agreement
  - Personal Guaranty
  - Lease Assignment
  - Confidentiality and Non-Compete Agreement

# **DUE DILIGENCE - Prospective Franchisee**

---

- FDD
- Talk to those in and out of the system
- Know the competition
- Consult knowledgeable financial professionals (accountants)
- State regulators
- Better Business Bureau
- Other attorneys

# What to Look for:

---

- Start With The Documents!
  - The Sales Materials & Promotional Pieces
  - The FDD
  - The Franchise Agreement
  - Any “Supplemental information” - representations



---

# **FRANCHISE AGREEMENT NEGOTIATIONS**

# The Franchisor's Perspective:

---

- Never
- No Way
- Good Try
- Try Again
- Not While I'm Here
- Are You Kidding
- See Ya
- Take it or Leave It
- It's Uniform/Standard
- No!

# The Franchisor's Perspective

---



# Reasons Why Franchisors Won't Negotiate

---

- No Need – Market Demand
- Standard “UNIFORM” contract – Now FDD
- Too burdensome to control
- If negotiate with one, will have to negotiate with all
- Maintain ultimate upper hand and strength

# Reasons Why Franchisors Might Negotiate

---

- Prospective franchisee is a potential customer
- Money talks
- You don't know unless you ask
- Be willing to walk
- Explanation/Rationale
- Unknown Factors

# **Business and Real Estate/Lease Issues**

---

- Individual vs entity as franchisee
- Type of entity
- Lease or real estate acquisition issues
- Licenses and Permits
- Insurance requirements
- Bookkeeping, tax and accounting issues

# **Thank you & Questions**

---

**We look forward to your participation  
tomorrow with Part 2.**

# **REVIEWING AND NEGOTIATING FRANCHISE AGREEMENTS, PART 2**

---

**Joel R. Buckberg**

**Baker Donelson Bearman Caldwell & Berkowitz, PC**

**Nashville, TN**

Direct: 615.726.5639

Fax: 615.744.5639

E-mail: [jbuckberg@bakerdonelson.com](mailto:jbuckberg@bakerdonelson.com)

**Harris J. Chernow**

**Chernow Kapustin, LLC**

**Horsham (Philadelphia Area), PA**

Tel: 215-659-3600 ext. 102

Fax: 215-659-3222

Email: [hchernow@chernowkap.com](mailto:hchernow@chernowkap.com)



# Agenda

---

- Major terms of franchise agreements and what's truly negotiable/what's not
- Scope of territory, rights within in it, and the opportunity to expand
- Understand the layers of fees, royalties and marketing expenses
- Operating standards and covenants – and opportunities for local variance
- Transfer and exit issues when a franchisee wants out

# Major Terms Negotiability

---

- Franchising is dynamic not static
- Franchisor has right to change ops manual and system/brand standards
- Standard terms change over time
- IT/IP issues
- What is scope of potential post-effective changes?
- How could changes affect you?

# Focus Areas

---

- Fees and payment terms
- Development/Acquisition Schedule
- Financing
- Sourcing/Suppliers
- Exit Rights
- Assistance/Training
- Marketing & Operations support
- Upgrading, Updating and Renovation
- Renewal & Relocation Rights

# Wall of Silence

---

- Insurance
- Indemnification
- IP Ownership and Rights/Inurements
- System control/brand standards/product control
- Sourcing/supply chain
- Enforcement & Remedies
- Governing law
- Dispute Resolution
- Know your state law, regulations and cases

# Major Terms Negotiability

---

- Fees
  - Initial Fees in Item 5
    - what is range from last fiscal year?
    - Formula change?
    - Deferral of payment with/without interest?
  - On-going Fees in Item 6
    - What is reported as variable?
    - Scale/Range/Growth Band
    - Royalties or equivalent

# Major Terms Negotiability

---

- Advertising & Marketing Fees
  - Rates
  - Allocation to markets/units
  - Grand opening support
  - Supplier rebates
  - Local spend mandate
  - Co-ops and regional spend

# Major Terms Negotiability

---

- Renewal Fees
- Transfer Fees
  - intra-family
  - controlled entity/estate planning
  - Time period/performance
- Other fees
  - vendor approval
  - audits
  - training
  - damages

# Territory

---

- Spot v defined area
- How to determine territory
  - Radius
  - Zip Codes
  - Population counts
  - Automotive counts
  - Designated Market Area
  - City vs suburbs vs rural
    - Type of City



# Territory

---

- It says it is exclusive? “Limited exclusive”; “non-exclusive”
- Carve Outs
  - Alternative Channels of Distribution
  - Internet
  - Mail Order
  - National Accounts
  - Different Marks for same type of business
  - Stand Alones/Unique venues – Universities, Hospitals, Stadiums, Airports, Train Stations, Supermarkets, Shopping Centers
  - Acquisition of competitor

# Territory

---

- Expansion/Growth – Maybe?
- Development Agreement
- Multi-Unit Franchise Agreement
- Right of First refusal
- Acquire large territory

# Indirect Fees

---

- Supply chain revenue in Item 8
- Financing revenue in Item 10
- Financial statements in Item 21
- Non-franchise channels in Item 12
- What is the franchisor's pie chart?

# Operations

---

- Understand variability/uniformity culture
- Freedom to innovate/respond to market?
- Top down v. bottom up v. two way
- Franchisee advisory council or independent association?
- Communications style – megaphone or microphone?

# Operations - Variance

---

- Terms of Franchise Agreement
- Operations Manual (Ops Manual)
- Local deviations – maybe?
- Regional Committees
- Approval
- Due Diligence
- Explain – show details

# Transfers/Exit Strategies

---

- Not like a true “independent business”
- Approval, Approval, Approval
- Typical requirements:
  - Notice
  - Opportunity to review buyer and terms of deal
  - Training for buyer
  - New franchise Agreement - \*\*\*\*
  - Release
  - Right of First refusal
  - Transfer Fee

# Transfers/Exit Strategies

---

- Things to consider
  - Allow for certain transfers
    - Among current owners
    - Immediate family
    - Up to 50%
    - Up to 10% (alternative)
    - transfer to trusts or other estate planning vehicles
    - Limited or Public Offerings

# Thank you & Questions

---

**Joel R. Buckberg**

**Baker Donelson Bearman Caldwell & Berkowitz, PC**  
**Nashville, TN**

Direct: 615.726.5639

Fax: 615.744.5639

E-mail: [jbuckberg@bakerdonelson.com](mailto:jbuckberg@bakerdonelson.com)

**Harris J. Chernow**

**Chernow Kapustin, LLC**  
**Horsham (Philadelphia Area), PA**

Tel: 215-659-3600 ext. 102

Fax: 215-659-3222

Email: [hchernow@chernowkap.com](mailto:hchernow@chernowkap.com)