American Bar Association
40th Annual Forum on Franchising

BETWEEN YOU AND ME:
A TOOLKIT TO COUNSEL IN AND TO SMALLER SYSTEMS

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October 18-20, 2017
Palm Desert, CA

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I. INTRODUCTION

A franchise system begins as an idea, develops into a business, and then germinates and grows. At this point in time, the business’ founder typically is still intimately involved with the business, and resources are in short supply. The founder may be serving as CEO, COO, and office administrator. Legal services, accounting services, contract administration, and franchise development may be 100% outsourced.

As outside counsel, we are typically asked to prepare the legal documents necessary to franchise – i.e., franchise agreements and disclosure documents – and to perform the services necessary to comply with regulatory requirements. The client comes to us for advice and for solutions to real-time problems, but mostly related to franchise development and resolving franchisee relationship issues. Sometimes the client may ask us to prepare execution copies of franchise agreements and/or review copies of advertising before publication. But rarely does our client ask us, and offer to pay us, to put together or advise on internal processes and procedures, such as those relating to advertising campaigns, franchisee screening, contract administration, and supplier agreements.

Once the client has reached a critical mass (maybe 50 or 100 franchises), it starts to look and behave differently. The company may have a chief operations offer and a director of franchise development. It may have a real estate and/or construction manager who oversees site selection and store build-out. It may have a contract administrator who prepares documents, coordinates background checks, and monitors franchisee compliance with insurance requirements. By this time, the company most likely has developed some of its own internal policies and procedures.

This is also the time that the company may – and likely should – consider hiring in-house counsel. As much as outside lawyers may tell themselves that they are acting as “outside/in-house counsel,” this simply is not true. An in-house corporate attorney, who often holds the title “Chief Legal Officer” or “General Counsel,” is present at board meetings, typically serves as an officer of the company, and owes a duty of loyalty to the company – which is his or her single client. It is the responsibility of in-house counsel to remain apprised of the company’s business, to identify and offer legal advice to the company as appropriate, and to manage the company’s legal budget. While we as outside counsel may be fond of our clients, may take an interest in their businesses, and may look out for their legal and business interests, the roles of in-house counsel and outside counsel are very different.

This paper is intended to memorialize the “passing of the baton,” so to speak, from outside counsel to in-house counsel. To do this, we follow a fictitious company – mBarkCo – which operates and franchises the operation of family entertainment centers featuring restaurant services, as well as a dog park, indoor pool, and other attractions designed to provide pet entertainment while pet parents enjoy their dining experience. After having grown to 100 franchises, mBarkCo is hiring its first in-house corporate attorney, Ian House. Mia Law-Firme has represented the company since its inception.

In chronicling the exchange between counsel, we also provide a toolkit for attorneys who may be new to franchising, including summaries and backgrounds of key legal issues. For ease of reference, we have divided the information by sections – exchanges and information concerning the franchise development team, the advertising team, suppliers, and franchisees.
II. FIRST REQUEST TO MIA LAW-FIRME

Dear Mia,

As you know, I have recently stepped into the role of Chief Legal Officer of mBarkCo. I understand that you have been serving as the company’s counsel and trusted advisor since it launched its franchise program. I wanted to write and introduce myself, and was also hoping that you might help me get up to speed with what I need to know to handle the issues that typically arise within a franchise company. If you have any best practices, guidelines or other materials that would improve procedures, or assist in managing the legal team, I would greatly appreciate if you would share them.

To give you some information about my background, before joining mBarkCo, I worked as in-house counsel for a non-franchise company in the restaurant industry. In gearing up for my current position, I did attend a franchise basics course, and I now have a working knowledge concerning the substantive requirements of a franchise disclosure document (“FDD”), and state registration and exemption requirements. So I’m not looking for a refresher in these areas. I’ve also read quite a bit about financial performance representations, and the company has just completed its annual FDD update. So let’s table that discussion until next year.¹

What I’m really looking for now are best practices and forms that I can use when dealing with the day-to-day management of a franchise system, including tips for advising my franchise development team and advertising team, and best practices for building relationships with suppliers and franchisees.

III. FIRST RESPONSE TO IAN HOUSE (RE: THE DEVELOPMENT TEAM)

Dear Ian,

So nice to meet you, and CONGRATULATIONS on your new position! I am happy to provide the information you requested. For convenience, this letter includes general information about franchise development. The remaining information will be provided under separate cover.

I know you mentioned that you are familiar with the restrictions on financial performance representations (I’ll provide information about sales and marketing under separate cover), so I wanted to focus here principally on the logistical side of the application process, for example, calculating the FDD waiting period, preparing a franchise application, and screening prospective franchisees. After all, new franchise sales are always good news for your bottom line, but I’m sure you understand the importance of having correct procedures in place to effectively manage the application process. If your development team is too focused on growth, and not paying enough attention to the details, as you know, the system may be exposed to substantial liability (most types not covered by E&O insurance).

¹ See Danell O. Caron and Sarah J. Yatchak, Basics Track: Registration & Disclosure, 50th Annual Legal Symposium (2017), for more information about the basics of FDD preparation and registration.
A. Calculating the Waiting Period

The franchise sales process is regulated at the federal level by the Federal Trade Commission’s franchise rule (the “FTC Rule”). As you know, the FTC Rule requires that a franchisor provide every prospective franchisee with a copy of its FDD at least 14 calendar days prior to signing any binding agreement with the franchisor, or paying any money to the franchisor. That waiting period might be extended if the franchisor unilaterally makes any changes to the material terms of the form of franchise agreement attached to its FDD (changes that were not the result of negotiations between the franchisor and the franchisee), because such changes must be delivered to a prospective franchisee no fewer than 7 days prior to signing any agreements or paying any fees to the franchisor, regardless of the date the FDD was provided. This statutory waiting period is intended to give the prospective franchisee sufficient time to review the FDD and the franchise opportunity, and consult with his or her attorneys and other advisors.

There are 15 states with their own version of a franchise disclosure statute: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin. For most of these states, the disclosure requirement matches that of the FTC Rule (i.e., disclosures must be delivered 14 calendar days before signing a binding agreement or paying any money), but a few of the state laws are different – in Iowa and New York, for example, disclosure obligations are also triggered by the “first personal meeting,” and in Maryland, Michigan, and New York, the waiting period is measured by 10 business days, rather than 14 calendar days (see Attachment A). The FTC Rule does not preempt any state law that is more favorable to franchisees; therefore, between the FTC Rule and the applicable state statute, franchisors should comply with the longest applicable waiting period.

The waiting period starts with delivery of the FDD to the prospective franchisee. Under the FTC Rule, that means the date that: (i) the FDD was hand-delivered, faxed, emailed or otherwise delivered, (ii) directions for accessing the document on the internet were provided, or (iii) a paper copy was sent to the address specified. However, despite the multiple available methods of delivery, the only statutorily approved evidence of receipt is the executed Item 23 Receipt (the last two pages of the FDD), which should be signed by the franchisee promptly upon receipt of the FDD. Although other methods of demonstrating receipt, such as delivery confirmations, may seem a practical alternative to a signed Item 23 Receipt, none of those methods are approved by state or federal law. Therefore, although saving such evidence in your records may be a good practice in case Item 23 Receipts go missing, we would certainly not recommend relying on such methods in lieu of obtaining a signed Item 23 Receipt.

Although calculating the end of the waiting period seems straightforward, it can be surprisingly challenging for a development team to correctly observe. In addition to keeping the
various state-specific rules of duration in mind and correctly applying them when the occasion calls for it (see Attachment A), there is the matter of correctly counting the number of days. The FTC Rule dictates that the date that the franchisor provides the FDD should not count towards the 14-day period – in other words, the franchisee should not sign any agreement or pays its fees until the 15th day after disclosure. Therefore, if the franchisor provides an FDD to a prospective franchisee on the 1st day of the month, the franchisee should not sign any agreement or pay any fees until the 16th of the month. This calculation can be counter-intuitive and result in the waiting period inadvertently being cut short.

B. Application Process

1. The Franchise Application

The process of evaluating a prospective franchisee can take anywhere from a few weeks to a few months. This process typically starts with the prospective franchisee completing and submitting a written franchise application. The application will collect certain basic biographical and financial information, as well as information about the candidate’s geographical area of interest. Upon receiving a signed application, your first step should be to review the jurisdiction of the prospective franchisee’s residence and the proposed unit’s site/territory. In addition to being able to use this information to determine whether the candidate’s proposed development is aligned with mBarkCo’s growth strategies, this information will allow you to determine whether any state specific statutes will apply to the sale. As you know, certain states require that a franchise be registered with a state agency before engaging in the sale, or be exempt from such registration. Additionally, the jurisdiction of the proposed franchisee/unit will impact other state specific requirements, such as the waiting period described above.

The franchise application is also the first opportunity to have a prospective franchisee sign certain minimum protections and authorizations before engaging in discussions with him or her. Although certain signed provisions are customary, you should be cautious not to include substantial, onerous or negotiated provisions in the application. Keep in mind that the FTC Rule waiting period must be observed before a prospective franchisee executes any binding agreement with the franchisor. Therefore, the franchise application is to be executed unilaterally by the franchisee, and is intended only to provide minimal protections. The most important provisions in the application are: (i) confidentiality – obligating the franchisee to treat all information it receives from you as confidential and proprietary, (ii) representations of accuracy – stating that you may rely on the information provided by the prospective franchisee as accurate and not misleading, and (iii) authorization to conduct credit and background checks on the prospective franchisee – which as discussed below requires signed authorization under certain applicable statutes.

2. Franchisee Due Diligence

Once you have received a properly executed application, it is time to do some research on the merits of that particular franchisee. This process can labor intensive, and some franchisors will only conduct a handful of the steps outlined below. For example, if a franchisee has obtained financing from a reputable bank, the franchisor may elect for a more streamlined approach to franchisee due diligence, under the assumption that the bank has already determined that the franchisee satisfies certain minimum standards. In either respect, many
franchisors will require their franchisees to make representations and warranties in the franchise agreement as to certain facts and conditions (i.e. the franchisee-entity is duly organized, none of the franchisee’s owners has been convicted of a felony, etc) – though of course knowing of these potential issues prior to the sale is preferable to pursuing a claim for breach of representations after the fact. For that reason, I’ve outlined a fairly thorough review process below for your consideration.

a. **Background Information**

Many factors will affect the company’s decision to offer a franchise to a particular person, including the candidate’s: (i) financial resources, (ii) business experience, (iii) cultural fit, (iv) personality, (v) integrity, (vi) management structure, (vii) prospects for obtaining a site, and (viii) proposed development schedule. Other factors may also be important to mBarkCo, for example, whether or not the franchise candidate is a certified pet trainer, or whether or not the candidate has owned and trained pets in the past. Each franchise company will develop criteria that suits its own unique business model.

Some of the information described above can be collected in the standard franchise application. However, the franchise application is only intended to provide general background information. We always recommend that our clients independently verify the information provided (by requesting supporting documentation and conducting additional investigations). For example, although the candidate will report information about his or her net worth, investments, and savings – requesting copies of recent tax returns, bank statements, and account summaries will provide the necessary supporting documentation. Similarly, while the application can collect basic biographical and business history, it is prudent to also obtain copies of business licenses, certificates, transcripts, or personal references.

One note of caution, however, when conducting your due diligence investigation, you need to be aware of the franchisee’s privacy rights. Although independent investigation is prudent, you should limit yourself to searching information that is publicly available (for example, on the internet and in public records), or contacting references authorized by the franchisee (for example, former employers). If you get too creative with your investigation, you could inadvertently violate the franchisee’s rights of privacy or attorney ethical guidelines – for example, you shouldn’t pretend to be someone else for purposes of “friending” the candidate on social media for purposes of learning more about him or her. Also keep in mind that when you obtain personal information about a franchisee, you should be sure to maintain it in a confidential and secure manner, so as to avoid potential data and privacy breaches and claims.

b. **Background Checks and Credit Checks**

Background and credit checks are fairly routine steps in the franchise application process; however, franchisors will have different standards as to which persons will be subject to these checks. Some franchisors take the better-safe-than-sorry approach and run both background checks and credit checks on every person who will be involved in the franchised business. Other franchisors draw a line between criminal background checks and credit checks – which of course serve different purposes. Criminal background checks will provide information about the candidate’s history of arrests or other matters that speak to that person’s integrity or personal judgment, whereas credit checks demonstrate financial stability. For that reason, many franchisors will run credit checks on individuals who will be financially responsible for the business – for example, all owners and guarantors; whereas, background checks will only be
run for individuals who will be involved in the active management of the franchised business – for example, operating partners, designated managers, and other active officers and directors.

When ordering any background or credit checks, it is important to remember to comply with the laws governing fair credit reporting and consumer protection. The most notable of these laws is the Fair Credit Reporting Act (FCRA), which makes it illegal to conduct credit or background checks without following certain procedures. These procedures can be summarized from a high-level as follows: (i) informing the applicant that you may use the information for purposes of deciding whether or not to grant him or her a franchise, (ii) the applicant’s right to obtain a copy of all reports that you obtain, (iii) obtaining written permission to conduct the checks, and (iv) certifying to the company from whom you obtain the report that you have complied with these requirements.\(^9\) Often these required notices and authorizations will be part of the standard franchise application. The FCRA also restricts your ability to take adverse action on the basis of the reports without notifying the applicant of your decision, providing a copy of the determinative report, a copy of the FTC’s published summary of consumer rights, and the contact information of the company that furnished the report.\(^10\)

c. OFAC and Sanctions

In screening prospective franchisees, it is also important to conduct a search of the lists maintained by the US Treasury’s Office of Foreign Assets Control (OFAC), which comprise a record of those individuals and entities whose assets are blocked by the US government as a result of sanctions. There are a number of reasons why a person or entity could end up on an OFAC list, some of which are as simple as the country of residence of such person being under sanction, but others are more nefarious, such as the person having been flagged for a connection with terrorism, narcotics trafficking, or violations of international trade laws. An OFAC search is easy to conduct online, and therefore although it may seem an extreme step, is an easy screening measure check off your list.\(^11\)

d. Citizenship and Visas

When qualifying a franchise candidate, we always recommend determining the applicant's citizen or immigration status, which falls into four main categories: (1) U.S. citizens, (2) lawful permanent residents, (3) temporary visa holders, and (4) undocumented immigrants.\(^12\)

Permanent residency rights are obtained through various types of applications. For example, foreign nationals seeking permanent residency may be interested in a franchise for purposes of applying for an EB-5 visa, which gives foreign nationals an opportunity to obtain permanent residency by investing a minimum of $1,000,000 in a qualifying U.S. business (or $500,000 if the investment is in a targeted employment or rural area).\(^13\) The principal criteria for obtaining an EB-5 visa is that the investment must create at least 10 new jobs within two

\(^12\) Cheryl L. Mullin, et al, New Kids on the Block: Awarding Franchises to Immigrant Franchisees, The Franchise Lawyer Vol. 15 No. 4 (Fall 2012).
\(^13\) 8 C.F.R. § 204.6(f) (2017).
years. For a well-funded foreign candidate desiring permanent residency, the EB-5 visa may be a very attractive option. Some franchisors have developed their own EB-5 programs and actively target investment, which sometimes includes the franchisor’s management of the business so that the candidate remains a passive investor. Some franchisors choose not to accept EB-5 visa candidates out of concern that he or she will lose interest in the franchised business after receiving his or her permanent resident status. Securing an EB-5 visa is also a somewhat lengthy process – often taking as much as a year (or sometimes longer) to obtain, which can affect the development timeline.

While awarding a franchise to a temporary visa holder may raise some operational concerns, there is an investment-based temporary visa worth noting. The E-2 Treaty Investor visa grants temporary immigration status to foreign nationals of treaty countries who are willing to invest a “substantial amount of capital” in a new U.S. business enterprise. The E-2 visa is issued for an initial two-year period, and can be renewed indefinitely in additional two-year increments so long as the investment still meets eligibility requirements at the time of each renewal. If the investment enterprise fails or the business is sold, the visa expires and the individual must leave the United States. Other types of visa holders (such as those awarded to professionals with extraordinary skills, advanced degrees, or other specific industry experience) may also make good franchise candidates. These visas may be less attractive to franchisors if temporary in nature, but in some cases, permanent residency can be applied for if certain criteria are met, or the temporary visa can be renewed indefinitely.

From the perspective of franchisee due diligence, the goal is of course to ensure that the franchisee has the lawful right to operate its franchised business in the US – which includes obtaining business licenses, obtaining financing, and maintaining bank accounts – for the duration of the franchise term.

e. Organizational Documents of Business Entities

If the prospective franchise proposes to operate its franchised business through a business entity, in addition to the other measures described above (i.e. an OFAC search for that entity), you should review the entity’s organizational and governing documents.

Organizational documents include articles or certificate of incorporation or organization for a filing entity (such as a corporation, limited liability company, or limited partnership), which demonstrate that the entity has been appropriately formed – plus a Certificate of Good Standing from the applicable state agency, demonstrating that the entity remains active and valid in the state of its formation. Governing documents typically include bylaws and/or a shareholders agreement for a corporation, a company or operating agreement for a limited liability company, and a partnership agreement for a general or limited partnership. If ownership is represented by certificated shares, you may want copies of the ownership certificates. Lastly, you may want to

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15 In 2016 the USCIS took an average of 478 days to process a petition for an EB-5 visa – see USCIS Processing Time Information, https://egov.uscis.gov/cris/pAllFormsAverage.do (last visited May 5, 2016).
request copies of all other applicable corporate records (such as resolutions, minutes, etc.) to ensure that the provided information has not been modified by written consent.

These organizational and governing documents should be reviewed for any provisions that would impact the terms of the franchise agreement, the operation of the franchised business, or your ability to pursue claims against the franchisee, such as:

- **Ownership.** More often than not, you will want to secure a personal guaranty from each of the entity’s direct or indirect owners, so it is important to review the organizational and governing documents to determine and verify ownership. If you fail to obtain a guaranty from the owners, your only recourse upon a default by the franchisee might be to pursue the franchisee entity, which might not have sufficient resources for you to recover damages or past due amounts.18

- **Authorization.** You should confirm that the persons signing the franchise agreement have the legal authority to do so, and that the persons who will be actively operating the business have the legal authority to take business actions (i.e. draw money from bank accounts, purchase insurance, etc.) on behalf of that entity. If the entity is a corporation the authorized parties will be the corporation’s “officers,” if the entity is a limited liability company, the authorized parties will be the LLC’s “managers” or “managing members,” and if the entity is a partnership, the authorized parties will be the partnership’s “general partners.” But you should read the organizational and governing documents to ensure that the signatories have the authority to bind the entity, and that such authority is not limited in any material way.

- **Restriction on Transfer.** Most franchise agreements restrict the transfer of the franchised business without franchisor approval, including any transfer of ownership interests in the franchisee entity. To ensure that all of the entity’s owners (some of whom may not have signed the franchise agreement) are aware of these restrictions and agree to abide by them, many franchisors will require that the entity’s organizational and governing documents incorporate these restrictions. For corporations, this restriction might appear as a restrictive legend on the entity’s share certificates, and for limited liability companies and partnerships, this restriction may be incorporated into the applicable operating agreement or partnership agreement.

- **Restrictions on Amendments.** To prevent further modification of the entity’s organizational and governing documents after they have been reviewed and approved, many franchisors require them to include a provision stating that the franchisor must be notified of and/or approve any future modifications.

The franchisee entity’s organizational and governing documents can become increasingly complex if any of its owners are themselves entities, trusts, or investment accounts. If an owner of the franchisee entity is another business entity, simply repeat the steps described above to ensure that you fully understand each level of ownership all the way up the chain. However, if any owner is a trust or investment account, you should also request copies of the trust and account documents, so that you can confirm which parties have a right to the proceeds

18 If your franchisee resides in a community property state, you are advised to check the local laws regarding how to bind the marital community. In Arizona, for example, both spouses must be joined in order to collect against a marital estate under a personal guaranty. See A.R.S. §. 25-214(C) (2017).
of those accounts. In most circumstances, if any beneficiaries or granting parties have the right to the proceeds of a franchised business, you might want those parties to sign personal guaranties, and you would want notice of any changes to such beneficiaries, so that you could obtain personal guaranties from any future beneficiaries.

The analysis of organizational and governing documents may also change if the franchisor is electing not to obtain personal guaranties from the owners of the franchisee entity. In that case, if the franchisee entity can easily distribute funds to its owners, the franchisor may find itself without recourse if the franchisee entity becomes insolvent or otherwise defaults under the franchise agreement. In such circumstances, the franchisor should be sure it understands the provisions in the franchisee entity’s organizational and governing documents pertaining to distributions. In some cases, the franchisor may go as far as requiring that the organizational and governing documents contain a restriction on distributions out of the franchisee entity to its owners. You can expect this type of requirement to be hard-fought by the franchisee, because the franchised business is intended to be a revenue stream for its owners; however, restrictions on distributions during periods of time when the franchisee-entity is in default under its franchise agreement may be considered a more reasonable approach in situations where no guarantee will be obtained from owners.

3. **Discriminatory Practices**

Developing objective qualification criteria and procedures, and applying them uniformly and consistently, is important to avoid the appearance of discrimination. The Civil Rights Act of 1991 prohibits intentional discrimination based on protected classes (e.g., race, religion, gender) in both making and enforcing private contracts.\(^{19}\) This statute has been interpreted by a number of courts to apply to a franchisor’s decision to award a franchise, enforce an agreement, or approve transfers.\(^{20}\) Therefore, it is important to keep in mind that using different qualification criteria and procedures for different candidates can expose the company to claims of illegal discrimination, unless the differences are supported by legitimate, nondiscriminatory business justifications and the practices are uniformly applied. For example, conducting a background check on each individual who will be actively involved in operating the franchised business would not be considered illegal discrimination, because active business involvement is not a protected class. Conducting background checks on a subjective, discretionary basis that results in different treatment of, or a disparate impact on, individuals in a protected class, however, could constitute illegal discrimination – even if nondiscriminatory factors contributed to the discretionary, decision making process. To avoid these claims, therefore, we always recommend standard reviewed procedures be adopted and uniformly applied.

C. **Going Dark**

Once your sales team is firing on all cylinders, it can be hard to slow it down again, let alone bring it to a halt. However, periodically you may be required to halt sales activities in one or more states, including abruptly in some circumstances. The most common examples of this arise when: (i) a state registration or exemption lapses, expires or is revoked, or (ii) a material change arises within your franchise system, and the FDD must be amended to reflect such


\(^{20}\) Id.
change. We call this period of halted sales efforts “going dark” and you may find yourself in the situation where you have gone dark in some or all states simultaneously, or with different or overlapping periods of time.

As you have indicated that you are familiar with the franchise registration process, I won’t go into the specifics associated with monitoring state registration expirations, approvals and exemptions – other than to say that the effective dates and renewal dates must of course be carefully documented and monitored.

However, you must also be sure that you have procedures in place that allow you to quickly recognize and act on any changes that may be deemed “material” to your franchise system. The FTC Rule requires that the FDD be amended to reflect a material change within a reasonable time after the end of each fiscal quarter. However, states have their own requirements concerning the timeliness of an update. Attachment B contains a list of the state deadlines for amending the FDD after a material change occurs. Some states require amendment “promptly” or “within a reasonable time” after a material change occurs, other states require amendment within a certain number of days after a material change occurs, and Hawaii requires amendment before any further sales. Even in states for which sales are regulated only by the FTC Rule, you should be cautious using an FDD after a material change occurs. Even though the FTC Rule gives you until after the end of the fiscal quarter to amend, franchisees may still have claims based on general common law principles of fraud or broad consumer protection statutes.

The FTC Rule defines a “material” change as any change that is likely to affect a reasonable prospective franchisee’s decision to acquire a franchise, and most states follow the same subjective test for materiality, which unfortunately can create some varying opinions as to what changes will be deemed material. Some material changes are easy to recognize – such as new litigation or a change in executive management. However, reasonable parties might disagree as to whether certain other changes should be deemed material. For example, if you increase the amount of your discretionary monthly technology fee from $25 per month to $50 per month, would that change be deemed material to a prospective franchisee? What if the fee is raised to $500 per month? The liability associated with getting this question wrong could unfortunately be quite high. In addition to possible fines and penalties imposed by state and federal government agencies, you could face claims for substantial damages from disgruntled franchisees (most state franchise and business opportunity statutes provide for a private right of action – though the FTC Rule does not) on the basis of violations of the applicable franchise or business opportunity statutes, as well as possible arguments that you violated generally applicable consumer protection statutes, and common law fraud protections. For these reasons, most franchise companies err on the side of updating their FDD early and often to reflect changes to the franchise system and program.

In addition to the subjective test of materiality, some states have codified certain occurrences as de facto material. These are presented on Attachment C. By way of example, in Hawaii and Wisconsin the repurchase by the franchisor of more than 5% of its outstanding franchised units in any three-month period is deemed material, and in New York the same test is applied over a six-month period. For a system of 1,000 units, the repurchase of over than 50

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16 C.F.R. § 436.7(b) (2017).

units in one three-month period might on its own have been recognized by the management team as a material change. However, for a system of 18 units, the repurchase of even one unit would trigger these provisions – notwithstanding that the repurchase, which may have arisen entirely in the ordinary course of business, did not seem material to the management team at the time it occurred.

Material changes sometimes go unreported due to failed communication between internal departments. For this reason, it is important to have regular open communication between departments, emphasizing the need to discuss any material changes to the franchise offering, the performance of franchised units, the composition or operation of the franchise company, and similar issues. Once a material change has been identified, franchise salespersons need to be notified that sales have halted, and that the existing FDD may no longer be disseminated until it is revised with new information and state registrations are amended appropriately. Many franchisors rely simply on periodic email notifications to members of its sales and development team, or a state-by-state chart of effective sales periods that is circulated from time to time – however, others attempt to automate the system by delivering FDDs only through an electronic system that can be turned on/off on a state-by-state basis to accommodate states in which they have gone dark.

IV. SECOND RESPONSE TO IAN HOUSE (RE: THE ADVERTISING TEAM)

Dear Ian,

I hope everything is going well! Here is the information you requested about advertising practices, including an overview of the issues concerning franchise and consumer advertising. As a preliminary note, you might want to share some of this information with your advertising team, so that they can use the information as campaigns are being created. This avoids having to be the “bad guy” who rejects the materials when the program is close to launch.

A. Advertising for Franchise Sales

Like the offer and sale of franchises, advertising for the sale of franchises is governed by the FTC Rule. Specifically, the FTC Rule declares it an “unfair or deceptive act or practice” to “make any claim or representation, orally, visually, or in writing, that contradicts the information required to be disclosed” under the FTC Rule, and to “disseminate any financial performance representations to prospective franchisees unless the franchisor has a reasonable basis and written substantiation for the representation at the time the representation is made, and the representation is included in Item 19 (§§ 436.5(s)) of the franchisor’s disclosure document.”\(^{23}\) In other words, franchisors may not include in its franchise sales advertising any financial performance information, unless the same financial performance information is included in Item 19 of the franchisor’s FDD.

At the state level, a few of the states with registration requirements also impose content requirements and/or restrictions, and/or require that copies of sales literature be filed with the state before first publication or use. Attachment D has a summary of these requirements.

Once the internet became part of our lives, state boundaries blurred. Questions arose about whether internet advertising constituted an attempt to sell franchises in states where the

\(^{23}\) 16 C.F.R. § 436.9(c) (2016).
franchisor was not registered to sell. Questions also arose about how to comply with state filing and content requirements. Before that time, radio and television advertisements were transcribed and submitted to the states before they were first broadcast. But internet sites suddenly hosted so much content — including video and audio — that transcription and filing became impossible as a practical matter.

Consequently, the Franchise and Business Opportunity Committee of the North American Securities Administrators Association (NASAA) attempted to solve for these issues by adopting a Statement of Policy Regarding Offers of Franchises on the Internet (the “NASAA Internet Offer Policy”)

According to the NASAA Internet Offer Policy, internet offers of a franchise are exempted from the registration requirements of state franchise laws if the following conditions are observed:

(A) “The Internet Offer indicates, directly or indirectly, that the franchise(s) is not being offered to the resident of [Jurisdiction];

(B) The Internet Offer is not directed to any person in [Jurisdiction] by or on behalf of the franchisor or anyone acting with the franchisor’s knowledge; and

(C) No franchise(s) is sold in [Jurisdiction] by or on behalf of the franchisor until the offering has been registered and declared effective and the [the Jurisdiction] Uniform Franchise Offering Circular has been delivered to the purchaser prior to the sale and in compliance with the [Jurisdiction] Franchise Law.”

According to the NASAA Internet Advertising Policy, any communication about a franchise offering posted on a website on the internet is exempted from the requirements for filing advertising if the following conditions are observed:

(A) “The franchisor discloses to the [Administrator] the Uniform Resource Locator (“URL”) address or similar address or device identifying the location of the Internet Advertising: (1) on the cover page of a franchise offering circular included with an application for registration that is effective in [Jurisdiction]; (2) on the cover page of a franchise offering circular included with an application for exemption from registration that is on file with the [Administrator]; or (3) on a notice filed with the [Administrator]; and

(B) The Internet Advertising is not directed to any person in the [Jurisdiction] by or on behalf of the franchisor or anyone acting with the franchisor’s knowledge.”

26Id.
27Id.
Most registration states have adopted some form of these policies. Therefore, when working with the advertising team to develop internet-based advertising, it is important to include the following information on the advertising itself:

This information is not intended as an offer to sell, or the solicitation of an offer to buy, a franchise. Currently, the following states regulate the offer and sale of franchises: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin. If you are a resident or want to locate a franchise in one of these states, we will not offer you a franchise unless and until we have complied with the applicable pre-sale registration and disclosure requirements in your state.

For Minnesota: Minnesota Registration No. [Insert Minnesota Registration Number].

For New York: This advertisement is not an offering. An offering can only be made by a prospectus filed first with the Department of Law of the State of New York. Such filing does not constitute approval by the Department of Law.

Also be sure to include the URL address on the cover sheet of the FDD!

B. Prize Promotions

Prize promotions are very popular, but may be considered an “illegal lottery” under state law if all of the following three elements are present: (1) consideration (typically, some form of payment, but may be nonmonetary); (2) a truly random chance to win; and (3) prizes. If one of these elements can be eliminated then the game is no longer an illegal lottery. For this reason, promotions typically are grouped into two categories: (1) games of chance, which eliminate the element of consideration or payment, and (2) contests of skill, which eliminate the element of random chance.

Games of chance can take various forms, such as sweepstakes (where winners are determined by a random drawing), and “instant win” promotions where winning game pieces are randomly seeded in the overall run of pieces. Whatever the form, they share one common element: winners are determined solely by chance. Chance promotions are subject to a host of state regulatory requirements, including registration, disclosure (including odds of winning), and in some states, escrow requirements. If combined with any form of payment or other consideration (even purchase requirements) chance promotions can become illegal lotteries, which may result in state enforcement action and/or civil damages.

Contests, on the other hand, are judged on the basis of skill. Properly structured and implemented, contests generally are exempt from laws regulating chance promotions because the element of chance is absent.

Both games of chance and contests are governed by the laws of the contract, with the “Official Rules” serving as the parties’ agreement. Game and contest rules, therefore, should explicitly describe, among other things, methods of entry, limitations on number of entries (if applicable), method of determining winners, eligibility (i.e., age, residence and the exclusion of employees and family members of the sponsor), commencement and expiration dates for
accepting entries, limitation on the sponsor’s liability, disclaimer of liability for lost, late and
misdirected mail and for printing and typographical errors on game pieces.

The Official Rules need also take into account the unique nature of each game or
contest promotion. For example, should the prize include a hunting trip, or the chance to race a
FORMULA 1™ racecar, there will be certain age and licensing requirements. Or if the contest is
open to children age 13 or older, parental consent and parental release of claims may be
required. In particular, the Official Rules should be drafted to address liability concerns with
respect to both standard and unique elements of the promotion.

The Official Rules also should require winners to sign both an affidavit of eligibility, and a
publicity release permitting the sponsor to advertise the winner’s name and likeness at the
conclusion of the promotion. Also recommended are disqualification and termination provisions
permitting the sponsor to disqualify individuals caught tampering with the entry process and to
terminate or modify any promotion that is adversely affected by outside factors such as
tampering, computer viruses, unauthorized intervention or technical failures of any kind.

We would be happy to help you develop your sweepstakes and contests, or to review
any rules or materials, if you need our assistance.

C. Price Promotions

Franchisors often engage in national or regional price promotions at the consumer level.
These may take the form of advertising products at a particular price, buy-one-get-one free (i.e.,
BOGO) promotions, or “free” giveaways. Whether or not the company can require franchisees
to participate in these types of campaigns depends on two things: (1) whether or not the
company has the contractual right, under the parties’ franchise agreement, to control retail
pricing, and (2) whether or not the practice is permitted under applicable antitrust law. With
respect to the first test, when we prepared mBarkCo’s standard franchise agreement, we
included a provision that requires the franchisee to participate in advertising promotions, and a
provision that gives the company the right to regulate minimum and maximum pricing, subject to
applicable antitrust laws. So unless a franchisee has negotiated a change to these
requirements, I am fairly confident that your franchise agreement provides you the contractual
authority to implement price promotions.

Before implementing such a promotion, however, it good practice to review and think
about applicable antitrust law. At the federal level, price restrictions are governed by the
Sherman Act, which very generally prohibits any “contract, combination in the form of a trust or
otherwise, or conspiracy, in restraint of trade or commerce…” This prohibition extends to
agreements to fix prices, rig bids, or engage in other anticompetitive activity. Before 1997, both
horizontal price fixing (i.e., agreements among competitors regarding price) and vertical price
fixing (i.e. agreements within the chain of distribution regarding price, sometimes called resale
price maintenance agreements) were considered illegal per se under the Sherman Act. Most
states have “mini-Sherman Acts,” most of which mirror their federal counterpart and provide

28 Section 5 of the FTC Act also extends to “free offer” advertising and, in 1971, the FTC adopted the FTC Free Offer
Guide, 16 C.F.R. § 251.1. (Regulating representations concerning the offer of “free” goods or services and similar
representations).
some authority for the courts to interpret the state law consistent with judicial interpretations of comparable federal antitrust states.\textsuperscript{30}

In the 1997 landmark decision, \textit{State Oil v. Khan}, the U.S. Supreme Court held that vertical agreements to set \textit{maximum prices} should not be judged illegal \textit{per se}, but rather should be evaluated under the “rule of reason.”\textsuperscript{31} Rule of reason analysis involves weighing the pro-competitive effects of the agreement against its anti-competitive effects, and is considered a much more lenient test. Consequently, it was generally accepted among the franchise bar that, under federal law, a franchisor could legally establish the maximum retail prices at which their franchisees could sell. But minimum pricing was still considered illegal \textit{per se}, so franchisors were still required to allow franchisees to sell at a lower price. Then in the 2007 decision, \textit{Leegin Creative Leather Prods. v. PSKS, Inc.} (a case involving a distributor’s agreement not to sell BRIGHTON accessories below the manufacturer’s suggested prices), the U.S. Supreme Court held that vertical agreements to set \textit{minimum prices} likewise should be judged under the rule of reason. This opened the door to pricing strategies and promotions such as the 99 cent menu.\textsuperscript{32}

This practice of setting minimum and maximum pricing for franchisees is now generally accepted within the franchise industry, and is thought to be consistent with federal antitrust law, provided that such practices do not result in a chilling effect on competition in the market.

As described above, most states’ antitrust laws are interpreted consistently with federal law, with a few notable exceptions:

- California – Vertical resale price maintenance agreements may remain illegal \textit{per se} under the California Cartwright Act, Cal Bus. & Prof. Code § 16720(a).\textsuperscript{33}

- Maryland – Md. Code Ann., Com. Law § 11-204 was amended in 2009, specifically to state that any “contract combination, or conspiracy that establishes a minimum price below which a retailer, wholesaler, or distributor may not sell a commodity or service” to be an unreasonable restraint of trade or commerce.\textsuperscript{34}

- New York – N.Y. Gen. Bus. Law § 369-a provides that “[a]ny contract provision that purports to restrain a vendee of a commodity from reselling such commodity at less than the price stipulated by the vendor or producer shall not be enforceable or actionable at law”).\textsuperscript{35}

With respect to franchisees located in these states, you may want to document your permission for them to sell at lower than advertised prices, for example in your operations

\textsuperscript{30} See, e.g., \textsc{Del. Code Ann. Tit. 6, § 2113 (West 2012)} (stating that the statute “shall be construed in harmony with ruling judicial interpretations of comparable federal antitrust statutes”); see also, \textsc{Fla. Stat. § 542.32 (West 2012)} (describing legislative intent that “due consideration and great weight” be given to federal antitrust law when interpreting state antitrust law).

\textsuperscript{31} \textit{State Oil Co. v. Khan,} 522 U.S. 3 (1997).


\textsuperscript{34} See \textsc{Md. Code Ann., Com. Law § 11-204(b)} (2017).

\textsuperscript{35} \textsc{N.Y. Gen. Bus. Law § 369-a (2006).}
manual. Also, any kind of price promotion should always indicate that it applies “at participating locations only” to protect franchisees who may not participate and to protect the brand if a franchisee elects not to participate.

D. **Comparative Advertising**

Clients ask me all the time whether it is legal to compare products to a competitor’s products, and to use the competitor’s trademarks in doing so. The short answer is that the law encourages comparative advertising (because it benefits the consumer), but representations are subject to the same truthfulness and substantiation requirements that apply to advertising claims generally.\(^36\)\(^,\)\(^37\) Disparaging advertising, as a form of comparative advertising, also is permissible so long as it is truthful and not deceptive.\(^38\)

An advertisement will be considered deceptive, under Section 5(a) of the FTC Act, if: (A) it includes a representation, omission or practice that is likely to mislead consumers; or (B) the representation, omission or practice is misleading from the perspective of the consumer acting reasonably under the circumstances; or (C) the representation, omission or practice is “material.”\(^39\)

One word of caution when considering comparative advertising, however, is to remain cognizant of the laws of trademark infringement when using a competitor’s trademarks. While the use of another’s trademark in commerce normally would constitute trademark infringement or unfair competition, proper use of another’s mark for comparative advertising purposes is considered “nominative use” (a sub-category of “fair use”) when the user uses another’s trademark to identify the product or services, as well as to promote their own distinct product or services. Courts have allowed use of a competitor’s trademark in advertising if it is accurate and not deceptive. In *August Storck K.G. v. Nabisco, Inc.*, for example, Nabisco touted on its LIFESAVER candy packaging that LIFESAVERS were “25 percent lower in calories than Werther’s original candy.”\(^40\) The Court held that use was accurate and not deceptive, thus permitted as a nominative use. In *Deere & Co v. MTD Prods., Inc.*, on the other hand, the Court enjoined MTD Products from using an animated alteration of the JOHN DEERE deer trademark in comparative advertising. There, MTD had portrayed the trademark deer as “in an animated

\(^36\) Federal Trade Commission, Commission Statement of Policy on Comparative Advertising (1979), https://www.ftc.gov/public-statements/1979/08/statement-policy-regarding-comparative-advertising (encouraging the use of comparative advertising where the comparison is clearly identified, truthful, and non-deceptive as it imparts important information to consumers and assists them in making rational purchasing decisions).

\(^37\) Federal Trade Commission, Commission Statement of Policy on Advertising Substantiation (1983), https://www.ftc.gov/public-statements/1983/03/ftc-policy-statement-regarding-advertising-substantiation (stating that, regardless of what claims are made, all claims must be substantiated, meaning that all claims must be supported by surveys, tests or other laboratory studies).


\(^40\) August Storck K.G. v. Nabisco, Inc., 59 F.3d 616 (7th Cir. 1995).
version, a deer that appears smaller than a small dog and scampers away from the dog and a lawn tractor, looking over its shoulder in apparent fear.41

Also keep in mind that there is no fair use exception available under copyright law. While use of a competitor’s trademark may be justified, it is never okay to display a stylized design version of a competitor’s mark or a competitor’s logo.

E. Testimonials and Endorsements

1. Social Media

Social media provides a unique and easily-accessible marketing medium for franchisors and franchisees by streamlining communication and interaction with consumers. In particular, social media platforms empower their users with the ability to render acclaim, but also criticism, about a brand, product, or service through testimonials and endorsements. A double-edged sword, these advertisements can promote brand or product recognition for franchisors and franchisees just as easily as they can create exposure to regulators for unlawful advertising.

Posts on social media outlets such as Facebook, Twitter, YouTube, and Instagram, involving a franchise’s brand, product, or service, constitute an “advertising message” as defined by the FTC.42 The regulations pertaining to “advertising messages” are specifically designed to apply to endorsements and other statements that a consumer is likely to believe reflect the opinion of a person other than the advertiser. As is often the case, social media posts express personal opinions on experiences with a franchise or sponsoring-advertiser. Accordingly, the FTC has regulatory purview over the manner in which advertisers and endorsers of products and services may control or disseminate these ads or posts.

Section 5 of the FTC Act prohibits unfair or deceptive trade acts or practices, including any material representation, misrepresentation, or omission, such as an advertisement or endorsement that misleads or is likely to mislead a reasonable consumer.43 The FTC has also promulgated further regulatory guidance, which provides the basis for voluntary compliance with the law by advertisers and endorsers.44 According to those regulations, “[p]ractices inconsistent with [the regulations] may result in corrective action by the Commission under Section 5 if, after investigation, the Commission has reason to believe that the practices fall within the scope of conduct declared unlawful by the statute.”

In recent years, the immense growth of social media created concerns about the new marketing opportunities for advertising-sponsors and their respective endorsers, potentially outside of the express regulatory boundaries of the FTC. In 2009, the FTC responded by specifically expanding the scope of its regulation of false and misleading advertising practices to social media, including testimonials and endorsements. Specifically, the FTC issued updated and broader-reaching guidelines for endorsements and advertisements, which advises among

41 Deere & Co. v. MTD Prods., Inc., 41 F.3d 39 (2nd Cir. 1994).
44 FEDERAL TRADE COMMISSION, COMMISSION GUIDE CONCERNING USE OF ENDORSEMENTS AND TESTIMONIALS, 16 C.F.R. § 255.0 (1980).
many other things, that any benefit conferred to the endorser in exchange for the promotion of a product or service must be disclosed within the social media post or ad.\textsuperscript{45}

For example, if a franchisor provides free samples of its products to a video-blogger (vlogger) on YouTube in return for a positive testimonial video of the product, then the FTC requires disclosure of that franchisor-vlogger sponsorship somewhere in the video itself. From a consumer’s perspective, it would be potentially misleading to view the video review without knowledge of the quid pro quo exchange between the franchisor and vlogger.\textsuperscript{46} Failure to comply with this disclosure mandate would subject the franchisor to an FTC unlawful advertising investigation and possibly corrective action. The FTC does, however, retain prosecutorial discretion and states that it would take into consideration all the facts and circumstances during its investigation, including efforts made by the advertisers to advise endorsers of their responsibility to disclose any conflict of interest.

The advent of sponsored-content in the digital media space highlights the expansive territory in which the FTC regulates and how frequent adaption of its rules and guidelines attempt to keep pace with the evolving nature of social media. Indeed, social endorsements and testimonials are not limited to traditional ads generated on Facebook posts or Twitter tweets and re-tweets. Ripe territory for applications of promotional advertising include live video game streaming platforms, such as TwitchTV, which provide endorsers with more lucrative opportunities to gain viewership and sponsorships from franchisors and franchisees.\textsuperscript{47} Invariably, the FTC faces a number of practical challenges in regulating how real-time streamers run sponsored advertising content. Often these videos last on the internet only for a short time and, therefore, much of the content is never checked and proving a violation is a challenge. Nonetheless, it is always a good idea to err on the side of transparency regarding disclosure of sponsorships and any interested parties.

The FTC continues to pursue deceptive advertising claims in the face of emerging challenges. On July 11, 2016, a settlement between Warner Bros. Home Entertainment, Inc. for alleged deception of consumers required paid online endorsers to disclose their social media posts regarding a video game release.\textsuperscript{48} There, the FTC took the opportunity to elaborate on the precise manner and placement required of sponsorship disclosures in YouTube description boxes.\textsuperscript{49} The FTC also has issued guidelines regarding podcasts and other informational media formats that host “experts” in their respective fields to opine on products and services only within their respective expertise if outside of an ordinary consumer’s knowledge.\textsuperscript{50} For example, according to the example portion of the regulation, physical therapist doctors cannot evaluate orally-administered supplements on a “question and answer” podcast sponsored by a fitness franchisor, but the same doctors could review foam rollers or tension bands.

\textsuperscript{45} 16 C.F.R. § 255.1 (2017).
\textsuperscript{46} AnnTaylor Stores Corp., 2010 WL 1638436 (F.T.C. Apr. 20, 2010).
\textsuperscript{47} TwitchTV, formerly JustinTV, https://www.twitch.tv (last visited July 1, 2017).
\textsuperscript{49} POM Wonderful, LLC v. F.T.C., 777 F.3d 478, 490 (D.C. Cir. 2015)
\textsuperscript{50} 16 C.F.R. § 255.3 (2017).
It is important to be aware that the FTC has provided detailed guidance for social media endorsements and testimonials, and likely will continue to tailor the existing guidelines to fit the expanding domain of social media advertising.

2. Publicity Rights

Publicity rights are intellectual property rights that enable an individual to control the commercial use of his or her own name, image, likeness, and other aspects of his or her own identity. The scope of publicity rights may even extend to quotes and social media aliases or handles. (Social media posts also may constitute original works of authorship under copyright laws.)

Publicity rights are defined by state law and may be codified to some extent. For example, in Ohio “a person shall not use any aspect of an individual’s persona for a commercial purpose” without written consent, and remedies for a violation can be either actual damages or statutory damages of at least $2,000 but not more than $10,000. Whether and to what extent publicity rights survive an individual’s death is a question of state law, and will be determined according to the law of the state in which the individual lived at the time of his or her death.

As a general matter, publicity rights must be considered whenever an advertisement includes the name, likeness, identity or content of an individual. This includes, without limitation (i) publishing a photograph of an employee or customer, and (ii) using a customer’s testimonial or endorsement. Such use may occur directly (such as when a photo is published on the company’s web site) or indirectly (for example, by contracting with a social media provider that automatically publishes identifying information whenever an individual “likes” a page or posting).

Misappropriation of an individual’s right of publicity, however, does not occur by simply re-posting or re-producing an individual’s name or likeness. There also must be some commercial value in that individual’s identity. Historically, there was a notion that only “celebrities” possessed publicity rights. However, with the rise of social media, ordinary people are achieving influential status through Facebook friends and Instagram and Twitter followers, thus proving that their identities have commercial value.

While it can be overwhelming, it is also important to understand how sponsorship and endorsements actually work with respect to the various social networking platforms. For example, Facebook previously offered a product called “Sponsored Stories.” Generally, the way it worked is that when a user “liked” an ad, the user’s name and photo would appear on all of his or her friends’ news feeds as having liked the product or company. In the class action case of Fraley v. Facebook, however, the class members (comprised of users whose names appeared in such ads) challenged the program, claiming that their names and likeness had been misappropriated. In that case, liability turned on whether the plaintiffs had to prove that commercial value pre-existed in their likeness prior to the misappropriation. While the parties in

51 OHIO REV. CODE ANN. § 2741.02(A) (2017).
54 Fraley v. Facebook, 830 F.Supp.2d 785 (N.D. Cal. 2012); Plaintiff’s Motion for Preliminary Approval of Class Action Settlement, Fraley v. Facebook, 2012 WL 2354653 (N.D. Cal. June 20, 2012).
the case ultimately settled, the court stated that despite the plaintiffs’ relatively unknown identities, misappropriation of a previously unknown identity may result in “economic injury or may itself create economic value in what was previously valueless.”\textsuperscript{55} Although this case resulted in liability for Facebook, not the advertisers, it is easy to imagine a situation in which the advertiser could have been named in the suit. It is therefore to consider the implications of advertising methods, even if such methods are standard when offered on a particular platform.

In an effort to avoid potential liability, some social media outlets have adopted posting rules that permit advertisers to use or re-post content within that respective outlet for commercial purposes. But it’s not clear whether these platform rules will apply if posted content is used on different outlets or platforms. Regardless, as social media continues to grow, the impact of publicity rights via social media posts remains subject to new and evolving legal interpretations.

3. Advertising via Telephone and the TCPA

In the same way that advertising on the internet and social media implicates unique regulations, certain additional laws may apply if you conduct any advertising via telephone. The Telephone Consumer Protection Act (TCPA) requires “prior written consent” from a consumer before making calls using “any automatic telephone dialing system.”\textsuperscript{56} It also requires a disclosure that the consumer is not required to consent to purchase goods or services. The Federal Communications Commission (FCC) enforces the TCPA and can levy fines of up to $11,000 per violation. Additionally, the TCPA allows a private right of action where consumers could recover the greater of (a) actual damages, or (b) $500/violation or $2,500 per willful violation.\textsuperscript{57}

The TCPA also applies to a person or entity that “makes” or “initiates” a text message. However, it is possible that even if a franchisee is the entity initiating the text to the consumer, that the FCC could take the position that the franchisor is also liable if the franchisor is distributing the manner and means to make the contact. In addition, the TCPA applies to auto-dialing mechanisms, but that definition is very broad. In the context of text messaging, since the message would be generated by automatic means, it would likely fall within the definition of an “automated telephone dialing system” (autodialer) under the TCPA and would therefore fall within its purview.

It is worth noting that there has been an issue about whether a company that hires a third party marketer to advertise its products will be liable if that third party violates the TCPA. Recent case law turns on how much control the company maintains over the third party.\textsuperscript{58} Requiring the third party to comply with TCPA in contracts would be helpful to ensure that the company shows appropriate concern for compliance. It is still an open question of how much policing of compliance is required or should be done.

\textsuperscript{55} Id. at 807.
\textsuperscript{57} See Id. at § 227(c)(5).
\textsuperscript{58} See e.g., Nigro v. Mercantile Adjustment Bureau, LLC, 769 F.3d 804 (2d Cir. 2014); Osorio v. State Farm Bank, F.S.B., 746 F.3d 1242 (11th Cir. 2014).
The TCPA requires “express written consent” from the consumer prior to sending the consumer any marketing text messages using autodialer technology. This means you cannot send one message and then provide the consumer with a mechanism to opt-out. The express written consent can take many forms, including acknowledging something on a website. The consent must include the phone number to which the consumer authorizes the delivery of text messages. There is no exception for preexisting business relationships, so the consent for a consumer to receive text messages, even if they are a longtime customer, must be express. Also note that the consent does not pass with a phone number being re-assigned. So if a consumer who previously gave consent changes phone numbers, the consumer must provide consent for the new phone number before a text is authorized.

A consumer may revoke consent to receiving text messages “by any reasonable means.” This phrasing has been the subject of several recent lawsuits. Generally, if a company allows consumers to text STOP, END, CANCEL, UNSUBSCRIBE or QUIT to end text messages, it is considered sufficient to revoke consent. Consumers may also revoke consent by consumer-initiated calls to the company, requests made in response to a call or text, and oral requests to the company. You should make sure you can demonstrate compliance with the TCPA by keeping good records of consumer consent for at least four years after sending text messages and have written procedures to process opt-out requests in whatever form they take.

V. THIRD RESPONSE TO IAN HOUSE (RE: SUPPLIER ISSUES)

Dear Ian,

You also had asked me to provide some background and best practices for supplier relationships. There are many legitimate business reasons for imposing sourcing requirements in a franchise relationship – to leverage volume pricing, to negotiate better distribution arrangements, and to assure uniformity of product offerings. For this reason, the franchisor typically reserves the contractual authority to require its franchisees to purchase most products and services from designated providers. This contractual authority, however, may be affected by federal and state laws. Additionally, even if such relationships are legally permitted, any arrangement that results in the franchisor or the franchisor’s affiliate deriving revenue or other material benefit based on franchisee purchases or leases must be disclosed in the FDD, as described in more detail below.

A. Preferred Vendor Programs

As you know, several states have so-called “relationship laws” that govern the franchisor’s rights of termination, nonrenewal, and right to refuse consent to a transfer of the franchised business. Sometimes referred to as “little FTC acts,” these state statutes may provide a franchisee with a private right of action against a franchisor for certain unfair and deceptive trade practices. As it is customary for franchisors to require franchisees to purchase goods or services directly from the franchisor or from “authorized” suppliers, it is important to be aware that certain states categorize unreasonable or over-broad supplier restrictions as an unfair or deceptive trade practice. To date, 21 states have enacted franchise relationship

59 See e.g., WASH. REV. CODE § 19.100.190(1) (2017) (these state statutes tie-back to and model the federally-crafted unfair and deceptive practices provisions in the FTC Act).
Below is a summary of the four states’ laws containing much broader provisions that extend to supply and/or supplier restrictions.

- **Iowa.** The Iowa Franchise Act is considered to be the most far reaching of the laws relating to supplier relationships, and includes restrictions on independent sourcing. This law specifically permits franchisees to obtain equipment, fixtures, supplies, and services used in the franchised business from sources chosen by the franchisee, provided that such goods and services satisfy the franchisor’s standards for such items. This does not apply to reasonable quantities of inventory goods or services that a franchisee must buy from the franchisor or an affiliate if such items are “central” to the franchised business, and are produced by or incorporate the trade secrets of the franchisor or its affiliate.

- **Indiana.** The Indiana Deceptive Franchise Practices Act (IDFA) generally declares as unlawful supplier restrictions that prevent the franchisee from obtaining goods or services of “comparable quality” available from other sources. However, the IDFA then exempts such restrictions that apply to goods trademarked by the franchisor or services that are subject to compliance with the franchisor’s specifications and standards. The IDFA also prohibits the franchisor from “coercing” the franchisee to, among other things, accept delivery of supplies, which are “neither necessary to the operation of the franchise, required by the franchise agreement, required by law, nor voluntarily ordered by the franchisee.”

- **Washington.** Under the Washington Franchise Investment Protection Act (FIPA), for any supply restriction to lawfully exist in the franchise agreement, the franchisor has the burden to establish that the restriction is “reasonably necessary for a lawful purpose justified on business grounds and do[es] not substantially affect competition.” Similar to Iowa’s Franchise Act, Washington’s FIPA also carves out an initial inventory exception to the general rule against supply restrictions. Importantly, the franchisor may also not require the franchisee to purchase products or services “for more than a fair and reasonable price.”

- **Hawaii.** The Hawaii Franchise Investment Law (HFIL) declares it an unfair or deceptive act or practice or an unfair method of competition for a franchisor to require a franchisee to purchase or lease goods or services of the franchisor or from designated sources of supply unless such restrictive purchasing agreements are reasonably necessary for a lawful purpose justified on business.

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61 Iowa Code § 537A.10(2) (2017).
62 Id.
64 See Ind. Code § 23-2-2.7-2(1)(i)-(iv) (2017) (categorically providing for four express acts of “coercion” of the franchisee by the franchisor).
66 Id.
Suppliers suggested or approved by a franchisor as meeting its standards and requirements are not deemed designated sources of supply.\textsuperscript{68}

Historically, preferred vendor programs have been challenged on grounds that they constitute illegal tying arrangements under antitrust laws. Tying arrangements arise when a supplier furnishes a product (called a “tying product”) to a buyer only on the condition that the buyer also buys secondary products (called the “tied product”) from the supplier. Tying is illegal when (1) the tying and tied products are separate and distinct, (2) the supplier has sufficient economic power in the market for the tying product to enable it to force buyers into purchasing the tied product, and (3) a “not insubstantial” amount of interstate commerce is affected.\textsuperscript{69} Tying arrangements have been found illegal under Section 1 of the Sherman Act and Section 3 of the Clayton Act, but federal courts generally recognize the rule promulgated by \textit{Jefferson Parish Hospital District v. Hyde},\textsuperscript{70} which states that the court will not presume anticompetitive effects of a tying arrangement unless the seller (or franchisor) has more than 30 percent market share for the tying product.

In the 1960’s and 1970’s, franchisees achieved some success in arguing that all source restrictions constituted illegal tying arrangements, with the franchisor’s trademark serving as the tying product. In the 1970 opinion \textit{Siegel v. Chicken Delight, Inc.}, the Ninth Circuit held that the legal uniqueness of a franchisor’s registered trademark, like that of a patent or copyright, combined with its power to impose the tie-in demonstrated sufficient economic power in the tying product market to render the arrangement illegal \textit{per se}.\textsuperscript{71}

The modern view is that the franchise trademark license is not a distinct and separate product, and therefore, cannot be a tying product, and recent attempts to advance the argument that a trademark is a tying product have failed.\textsuperscript{72} In 2006, in \textit{Little Caesar Enters., Inc. v. Smith}, for example, a class of franchisees accused the franchisor of unlawfully tying the sale of branded paper products to the franchise. \textsuperscript{73} The franchisee alleged that the tying product was the franchise and the tied products were logoed paper goods. The franchisor argued that the logoed products and other distinctive materials are not tied products because they would not have any market value and could not be sold anywhere else apart from a franchised restaurant. The court rejected the franchisor’s argument and found that the franchise and paper products were not in separate markets and that other private distributors, unrelated to the franchisor, sold the goods necessary to run a Little Caesars franchised outlet.\textsuperscript{74} In reaching its decision, the court evaluated whether it would be efficient for an organization to provide the ancillary products separate from the franchise and found that two distinct markets existed because, in the past,

\begin{itemize}
  \item \textsuperscript{67} H.R.S. § 482E-6(2)(B) (2017).
  \item \textsuperscript{68} Id.
  \item \textsuperscript{69} \textit{N. Pac. Ry. Co. v. United States}, 356 U.S. 1, 5-6 (1958).
  \item \textsuperscript{70} \textit{Jefferson Parish Hospital District v. Hyde}, 466 U.S. 2 (1984).
  \item \textsuperscript{71} \textit{Siegel v. Chicken Delight, Inc.}, 311 F. Supp. 847 (9th Cir. 1970).
  \item \textsuperscript{73} \textit{Little Caesar Enters., Inc. v. Smith}, 34 F. Supp. 2d at 459.
  \item \textsuperscript{74} Id. at 469.
\end{itemize}
private distributors unrelated to Little Caesars sold all the goods necessary to run a Little Caesars franchise.\(^{75}\)

Other challenges to proving an illegal tie include defining the relevant market and establishing that the franchisor possesses requisite market power. In *Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, a group of franchisees claimed that the relevant market constituted the franchisees themselves, all of whom were invested in the franchise system, making it economically impractical for them to abandon the Domino's system and enter a different line of business.\(^{76}\) The district court dismissed the antitrust claims with prejudice, holding that the franchisees failed to allege a “relevant market” as required by the Sherman Act. On appeal, the Third Circuit affirmed the dismissal holding that there could be no tying claim where the defendant’s “power” to “force” plaintiffs to purchase the alleged tying product stems not from the market, but from the parties’ franchise contract, which includes sourcing restrictions.\(^{77}\)

**B. Supplier Rebates**

Supplier rebates are common in franchising, and necessary when dealing with some suppliers, who (as a matter of practice) will only offer marketing fund dollars and rebates, rather than best price. Nonetheless, franchisees view the practice unfavorably, and sometimes believe (albeit incorrectly) that a franchisor’s receipt of money from suppliers constitutes an illegal bribe or kickback. This is not the case, but there are some parameters to keep in mind.

The FTC Amended Rule requires that certain information about supplier arrangements be disclosed in Item 8 of the FDD. Specifically, a franchisor must disclose “[w]hether the franchisor or its affiliates will or may derive revenue or other material consideration from required purchases or leases by franchisee.”\(^{78}\) If so, the franchisor must disclose “the precise basis by which the franchisor or its affiliates will or may derive that consideration by stating:

- The franchisor’s total revenue.
- The franchisor’s revenues from all required purchases and leases of products and services.
- The percentage of the franchisor’s total revenues that are from required purchases or leases.
- If the franchisor’s affiliates also sell or lease products or services to franchisees, the affiliates’ revenues from those sales and leases.\(^{79}\)

Compliance with the guidelines requires description of present relationships (e.g., under a current arrangement, the franchisor receives payment from a food supplier ranging from 5% to

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\(^{75}\) Id.


\(^{77}\) *Queen City Pizza, Inc. v. Domino’s Pizza*, 124 F.3d 430 (3d Cir. 1997).

\(^{78}\) 16 C.F.R. § 436.5(h) (2017).

\(^{79}\) Id.
10% of the sale of certain food items, etc.). It also requires historic disclosures (e.g., actual revenue derived during the prior fiscal year from required franchisee purchases and leases).

In addition to disclosure requirements, the Robinson-Patman Act of 1936 prohibits price discrimination with respect to commodities (but not services), and broadly prohibits brokers, agents, and other intermediaries between sellers and buyers from receiving payments that are not for services rendered. Certain claims also have been brought by franchisees alleging that franchisor rebates were illegal kickbacks violating Section 2(c) of the Robinson-Patman Act. These types of claims, however, typically fail on grounds that franchisees cannot show the type of injury necessary for antitrust standing.80

VI. FOURTH RESPONSE TO IAN HOUSE (RE: FRANCHISEE ISSUES)

Dear Ian,

Once a franchisee has executed its franchise agreement, it’s easy to assume that the hardest part is behind you – not the case! Successfully managing the continued operation of the business requires a considered approach, especially in the context of certain circumstances that can have high stakes for the parties involved, such as when a franchisee wishes to sell its unit, the franchisee is not meeting its obligations under the franchise agreement, or one of the parties wishes to terminate the relationship. Pursuant to your request, the following is an overview of the major considerations affecting the ongoing franchise relationship.

A. Sales and Transfers

When a franchisee decides to sell its franchised business, having the proper procedure in place can be critical to a smooth transition. In most circumstances, the first step in a franchise transfer is the franchisee notifying the franchisor that it has found a buyer for its franchised business (although in some circumstances a large franchise system may have a program available that matches franchisees that wish to sell their unit with prospective buyers). Once a franchisee has identified a prospective buyer, the process will typically unfold in two principal stages: (i) securing the franchisor’s approval, and (ii) preparing the transfer documents.

1. Franchisor Approval.

When a prospective buyer is being screened, most franchisors will follow a procedure that is much the same as with screening any other new franchisee (see Section III.B above). But in addition to the standard methods of evaluating the buyer as a new franchisee, the franchisor must also evaluate the transaction itself, beginning with the purchase agreement. Although the extent of the review of such documentation will depend on the franchisor’s resources and risk-aversion, we have elected to outline a fairly thorough approach to this process. After all, the purchase agreement between buyer and seller controls the terms of the transfer, and the franchisor should review for certain key provisions:

- Purchase Price. Although the franchisor is neither paying nor receiving the purchase price, franchisors will still be interested in terms of how the purchase price will be paid

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because it will impact the buyer’s ability to financially support the business after closing. The franchisor will want to compare the amount of the purchase price to the financial resources of the buyer, to ensure that enough funds remain to support ordinary business operations of the franchise after the purchase transaction is completed.

- **Conditions to Closing.** For the franchisor, the most critical condition to closing is of course the prior approval of the franchisor and satisfaction of the conditions to transfer set forth in the franchise agreement. It is critical to ensure that the purchase agreement contemplates obtaining such approval and satisfying such criteria prior to effecting the closing. However, you should also be sure you understand all of the other conditions to closing, so that there are no unexpected hurdles to a smooth transition, or terms that conflict with the franchise agreement.

- **Assets.** If the buyer is acquiring all of the assets of the franchised business, you should be sure to review the description of the transferred assets carefully to ensure that only property of the seller is being transferred. For example, under most franchise agreements, the franchisor will retain ownership rights to its intellectual property, goodwill, customer data and other intangible assets associated with the franchise system. These assets should be excluded from the description of purchased assets to make clear that they belong to the franchisor, and not the selling franchisee.

- **Financing.** If the buyer has financed any portion of the purchase price, you may want to review the financing documents, to make sure that the buyer’s payment obligations to the bank are subordinate to his or her obligations to pay royalties and other amounts owing under the franchise agreement. Additionally, if the buyer has offered any of its assets as collateral for the loan, the franchisor should ensure that such collateral interest does not attach to the goodwill or trademarks associated with the business.

Certain states’ laws also regulate the franchisor’s ability to approve or disapprove a franchise transfer. Attachment E summarizes these laws. To summarize, five of those states’ laws require the franchisor to review the proposed transfer within a certain timeframe, so as to avoid the franchisor dragging its heels. This time frame can range from 30 days to 60 days, and will obviously impact the timing of your approval process. These statutes also state that a failure of the franchisor to respond within the specified timeframe will constitute an approval, on the basis of which the franchisee may sell the unit without further notice to the franchisor. Additionally, most of these states require the franchisor to specify in its notice the reasons for any disapproval.

Seven states’ laws contain some form of restriction on the franchisor’s ability to freely disapprove of a transfer. In some cases, this restriction is quite broad, such as stating that the franchisor must disapprove a transfer only in a reasonable manner. In other cases, the franchisor must have good cause, such as the proposed transferee fails to meet standard qualifications for a new franchisee, or one of the parties is in default to the franchisor. The most common prohibition, however, is a restriction on the franchisor’s ability to prevent the surviving spouse or heir of a deceased franchisee (or majority owner) from taking over the business, provided that they satisfy franchisee qualifications within a reasonable time. Lastly, Iowa law

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81 See e.g., IOWA CODE § 523H.5 (2017).
specifically restricts the franchisor’s right to require a transferee sign a new form of franchise agreement, which is common practice in many franchise systems.\textsuperscript{82}

2. Transfer Documents

In documenting the transfer of a franchise, the franchisor will typically prepare a document to memorialize its conditional consent to the transfer, which can have many names, such as “consent to transfer” or “transfer agreement.” The transfer agreement will typically be executed by the franchisor, and both buyer and seller, as well as their owners/guarantors. The form of the transfer agreement can vary significantly, but will typically have the following standard provisions:

- **Consent/Waiver.** The franchisor should grant its consent to the transfer in clear language, subject only to the other terms of the transfer agreement. Additionally, if the franchise agreement grants the franchisor a right of first refusal, some franchisees will ask the franchisor to include a specific waiver of this right of first refusal.

- **Conditions to Consent.** Because the transfer agreement is often signed in advance of the closing, the approval by franchisor will typically be subject to a number of conditions that must still be met prior to the closing date, including: (i) execution of new franchise documents by the new franchisee, (ii) payment of a transfer fee, (iii) onboarding of the new franchisee, such as attendance in the initial training program, (iv) any outstanding remedial actions at the business to clean up defaults or bring the unit into current compliance, which may include any remodeling to new or updated system standards, (v) satisfaction of all closing conditions in the purchase agreement between buyer and seller, (vi) approval by the landlord and/or transfer of the lease agreement to the buyer, (vi) subordination of any financing to the obligations of buyer under the franchise agreement, and (vi) any other transition matters (i.e. bank accounts, insurance policies).

- **Release.** Most franchisors will seek a general release of all claims from selling parties, releasing all prior claims against the franchisor and its affiliates. The selling franchisee is often bound to agree to such a release by the terms of its franchise agreement. Keep in mind, however, when requesting a general release, that four states have requirements pertaining to releases: (i) California mandates certain specific language be included in the general release for it to be enforceable,\textsuperscript{83} and (ii) Iowa, Washington and Maryland prohibit certain releases as a condition to a franchise transfer.\textsuperscript{84}

- **Termination of Seller.** Upon transfer of franchise business, the franchise agreement of the selling franchisee should be terminated, so that the buyer is the only party with franchise rights to that unit. That termination is often documented in the same transfer agreement, but will specifically carve-out any outstanding payables and post-termination

\textsuperscript{82} Id.

\textsuperscript{83} CAL. CIV. CODE § 1542 (2017).

\textsuperscript{84} See, e.g., IOWA CODE § 523H.5.8 (2017) (prohibiting a franchisor from obligating a franchisee to undertake obligations or relinquish any rights unrelated to the franchise proposed to be transferred); Interpretive Statement Business Franchise Guide (CCH), ¶ 5470.76 (cannot include a release of claims under the Washington Franchise Investment Protection Act).
obligations (such as non-competition, confidentiality, and non-disparagement), for which
the selling franchisee will remain liable.

The transfer agreement may also vary depending on the nature of the transfer. For
example, if the transfer is not of the entire franchised business, but only of an ownership interest
in the franchisee, the only condition may be that the new owner signs a personal guaranty of the
existing franchise agreement.

B. Managing Compliance

A franchise system of your size will experience defaults by franchisees in every shape
and size. Some may be as simple as poorly cleaned bathrooms; others may be more serious,
such as failure to pay royalties, unauthorized transfers, or disclosure of confidential information.
The options for how to address and remedy these defaults can vary across the board, from a
short phone call to the defaulting franchisee, to a letter terminating the franchise immediately,
but most of them start the same way: (i) identifying the default, (ii) documenting the default, and
(iii) creating a plan for remediation.

In identifying the default, most of the burden will fall on the operations and support team,
which is tasked with inspecting the premises, communicating regularly with the franchisee, and
understanding the trends in each relevant geographic area. The operations and support team
should be instructed to promptly notify you of any observed defaults, operational issues, or bad
performance indicators promptly after identified. In some cases, such team members may be
inclined to offer additional “chances” to persuasive franchisees, or attempt to resolve the matter
informally, or without keeping records of the default. Therefore, it can be useful to have written
policies outlining the expectations for reporting operational concerns to the corporate office.

After a default has been identified, it is important to document the default as part of the
franchisee’s file. In addition to simply maintaining a record of defaults to support any future
disputes, another purpose for documenting the default is to establish evidence of a pattern, in
case they continue to arise. Many franchise agreements give broader rights and remedies to a
franchisor when a franchisee repeatedly violates the same rule; therefore, it is a good practice
to save evidence of each default that arises, no matter how small, in case a pattern of non-
compliance emerges. The form of this evidence is very straightforward if the default was
observed as part of a routine inspection, for which the inspection report can be saved.
Otherwise, for less material defaults, an email outlining the specifics may be sufficient. But more
often than not, the safest approach is to send a default notice – which calls out the specific
provision of the franchise agreement that the franchisee is breaching. Another purpose for such
a formal notice is to start any applicable notice/cure period required under state law tolling as
soon as possible. A number of states have statutes that require franchisors to provide notice
and an opportunity to cure defaults to each franchisee before terminating the franchise
agreement. Attachment F summarizes specific default notice and cure periods under state
statutes. If a state statute applies, it is wise to take the more formal approach and outline both
the applicable breach and state cure period (if any) in a written default letter.

Whatever form it may take, the default notice sent to the franchisee should include a
description of the default, the date/time it arose, the manner in which it was observed, and the
deadline by which it must be corrected. This background information can sometimes be the only
complete record of the default, especially for defaults observed in person, so it is important to
have such information be as accurate and specific as possible.
Once the franchisee has been made aware of the default, the process of managing the compliance issue is principally one of tracking. You should calendar dates for your operations team to follow up with the franchisee or re-inspect the premises. You should also calendar the expiration date of any applicable cure period (with a careful eye to observe any state law required notice/cure periods above). It is surprisingly easy to allow defaults to go on longer than they should simply because re-inspections and cure periods are not being conscientiously tracked. After any re-inspection, additional notices should be sent to either reflect a failure to cure (in much the same manner as the original default) or the successful remediation.

C. Exiting the System

Neither the franchisor nor the franchisee wants a relationship to fail, but in some circumstances, a graceful exit from the franchise system is the best option for a franchisee. Because most franchise agreements do not permit franchisees to terminate without a substantial breach by the franchisor, most franchise terminations are either mutual in nature or effected unilaterally by the franchisor based on one or more defaults by the franchisee.

1. Mutual Terminations

In the context of a mutual termination, the parties agree in writing to the terms on which the franchisee will exit the system. The parties will typically sign a termination agreement, outlining the terms on which the unit will be reacquired or closed, and the settlement of any outstanding amounts owed or other damages. The termination agreement will naturally be specific to the facts and circumstances of each individual termination, but will typically include a number of key provisions, such as:

- **Purchase/Closure of Unit.** If the franchisor elects to reacquire the unit, the termination agreement may contain the purchase terms and conditions, including purchase price and closing conditions. Otherwise, the termination agreement will typically reiterate the broad de-identification and closure obligations under the franchise agreement, as well as calling out any other specific steps the franchisee must take to wind-down its operations. Such steps may include returning property of the franchisor, removing branded signage, painting any uniquely colored walls, cancelling trade names, or transferring administrative controls over any social media accounts.

- **Settlement of Damages.** In addition to paying the franchisor any outstanding royalties or other amounts owed, some franchisors try to recoup a portion of lost future revenue. Some franchise agreements specifically require the franchisee to make good on the value of the full term of the franchise agreement. But even without such a provision, the franchisor may be able to recover such amounts through litigation. Therefore, if the franchisee is solvent, the franchisor will often try to recoup some portion of such damages through a lump sum payment at termination, and will outline the amount and terms of such payment and any other amounts past due in the termination agreement.

- **Release.** As with transfers, most franchisors will seek a general release of all claims from franchisee parties to the termination agreement, releasing all prior claims against the franchisor and its affiliates. As discussed above in Section VI.A(2), some states have requirements pertaining to releases that should be carefully observed.

- **Termination.** The termination agreement will, of course, also terminate the underlying franchise documents for that location. However, certain post termination obligations will
be reaffirmed, such as payment of amounts due, indemnification, non-competition, confidentiality, and non-disparagement.

2. **Unilateral Terminations**

A unilateral termination of a franchise can be more complex, because it is conducted without the input or acquiescence of the franchisee, resulting in a situation that is ripe for disputes. In most cases, franchisors will resort to a unilateral termination only after all other reasonable options have been exhausted, or the defaults rise to the level of serious health, safety or brand reputation concerns. As discussed further in Section VI, you should only consider proceeding to termination if you have complied with the applicable notice/cure period provisions under state law (see Attachment F), as well as any applicable cure period or other terms and conditions under the applicable franchise agreement. In such circumstances, it is also prudent to outline with specificity the applicable provision under the franchise agreement giving you the right to effect such termination.

A notice of unilateral termination can also contain many of the same demands that might have otherwise been resolved in the mutual termination agreement, such as a demand for payment of amounts past due, lost future revenue, and compliance with all post-termination obligations under the franchise agreement. As with tracking defaults generally, it is important to track the status of each such demand, and follow-up promptly if the terminated franchisee does not promptly comply with each obligation.

Additionally, some states prohibit termination of a franchise without meeting some standard of “good cause.” The intention of such a statute is of course to prevent the unjustified forfeiture of a franchised business, which can in some cases be the sole source of family income. Attachment F summarizes the applicable state relationship laws that apply to termination for “cause.” In any unilateral notice of termination in one of these states, you may want to consider identifying the specific “cause” under the state statute, as well as under the underlying franchise agreement.

Lastly, some state relationship statutes also require the franchisor to buy-back inventory and supplies of the franchised business at termination. Attachment F summarizes the applicable state statutes pertaining to termination/buy-back. These regulations are another consideration to keep in mind, and ensure that you make such offer (if applicable) upon termination.

**VII. SECOND REQUEST TO MIA LAW-FIRME (RE: I WISH I HAD KNOWN!)**

Dear Mia,

I really appreciate all the information you provided. Franchising touches so many different areas of the law, it’s hard to know what you don’t know. And while of course hindsight is always 20/20, I wanted to share with you some of the insights I gained, that you may be able to pass on to your clients who manage younger systems. Let them learn from our mistakes!

A. **Naming Conventions**

I know this is a business function that doesn’t require legal advice, but I’ve spent the last couple of weeks getting to know our franchisees. Some I know by name, some by company, and some by location. It’s been quite the ordeal trying to get the management team to agree on some uniformity going forward! To address all of the general confusion in identifying our
franchises, I first developed a naming convention for each location. Each of our units is now numbered (1-100) and also has an internal name associated with their location. For example, we have 2 locations in Phoenix, and we named one Phoenix North (#45), and the other Phoenix South (#62). I also reviewed all internal records to make sure we were correctly identifying all franchisees by their legal name, not the name of any of their principal owners or any other shorthand, so that all documents were prepared correctly and we could quickly identify the legal party acting as the franchisee for each unit.

B. Execution Formalities

I understand that “getting the deal done” and collecting initial franchise fees are of paramount importance and, as outside counsel, you have no control over what ultimately gets signed or how it gets signed. I just wanted you to know that I am looking at 100 copies of your brilliantly crafted franchise agreement (1) signed by companies that were never formed, (2) with signatures that don't match the names of the parties, (3) without personal guaranties or other security documents, etc. I’m hoping that they all can stay in the drawer! Going forward, I have instituted strict execution formalities. In addition to observing all the guidance you provided in Section III.B(2)(v) to confirm that each franchisee that is a business entity is properly formed, in good standing, and authorized to enter into such an agreement, I have taken steps to ensure that: (i) all documents have legible signatures, (ii) if multiple signatures are on one page, that all such signatures have been secured, (iii) documents with a date line have been dated, (iv) guaranties with a spousal signature line have been executed by the spouse, and (v) all names match their respective signature. Going forward, we are also considering implementing an electronic signature process, with the hope that it will allow us automate the process and prevent missed signatures, dates and other errors.

C. Business Records

Time and time again I have been asked by our operations team to draft a notice of default for a franchisee, only to discover we did not have a complete record of that franchisee’s documents! I have worked tirelessly with our records department to try to unearth complete records for all of our franchisees from our archives. I am proud to say that we now have a complete business record for each franchised unit, including: (i) a signed Item 23 FDD Receipt, (ii) a copy of the franchise application, and any supporting documents, (iii) executed and complete copies of all franchise agreements, guaranties, and any other ancillary documents, (iv) executed copies of the franchisee’s lease for its premises, and our standard franchise lease rider, (v) copies of the franchisees insurance policies, naming us an additional named insured, (vi) executed authorizations for the royalty and other payment sweeps of the franchisee’s business account, (vii) copies of all inspection reports, default notices, and other correspondence relating to operational issues, and (vi) any other documents, consents, waivers, agreements, or notices pertaining to the franchise. Additionally, I have begun training my sales and operations team to routinely save all correspondence with franchisees or prospective franchisees, so that we have a robust record of our communications with such persons.

D. Ancillary Documents

Although our FDD contains all our standard franchise documents, including the franchise agreement and our standard franchisee questionnaire, there are some elements of the franchise relationship which I fear have not been appropriately documented. Therefore, I have been in discussion with our operations team to determine whether we might be able to clarify expectations, reduce liabilities, and outline obligations in a number of other key areas by
incorporating additional written agreements or acknowledgements. For example, a written document could be useful in: (i) confirming final site selection, (ii) certifying the unit is ready to open and complies with applicable laws, (iii) leasing the franchisee equipment, (iv) licensing the franchisee’s software, intranet access or other technology, (v) terms and conditions for participation in gift card or loyalty programs, (vi) payment/ACH authorizations, or (vii) terms and conditions for any franchisor-managed supplier arrangements or purchasing programs.

E. Company Representative

I know that, in a young company, everyone wears many hats and that, as our outside counsel, you probably were the most qualified person to negotiate and document a deal or work out a dispute. But this created somewhat of an issue: you did such a great job, and management was so trusting of your counsel, that there is no one in the organization with personal knowledge concerning the history of anything! We now have a potential lawsuit brewing concerning the termination of a franchise location, and it appears that all of the default notices as well as the termination letter went out on your letterhead. So unfortunately, if this develops into litigation, I may need your testimony to authenticate the notices (I’m not sure if we can get them in through a business records affidavit), and may also need you to testify at trial.

VIII. THIRD REQUEST TO MIA LAW-FIRME (REQUEST FOR PROPOSAL)

Dear Mia,

Thanks again for all the information, and for all that you’ve done for mBarkCo. Your guidance is greatly appreciated. Going forward, I believe that relationships mean everything, and I would like to continue our relationship in areas within your firm’s expertise. However, because I am responsible for managing our company’s legal budget, and outside counsel relationships, I wanted to pass-along mBarkCo’s billing policies for outside counsel (see Attachment G). We ask that all our outside counsel follow these guidelines. I hope that you and I have many opportunities in the future to work together. Thanks again for all of your help. I look forward to speaking soon!
## Attachment A

### Summary of Disclosure Waiting Periods

<table>
<thead>
<tr>
<th>States</th>
<th>Waiting Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Iowa</td>
<td>FDD must be given the earliest of: first personal meeting or 14 calendar days before execution or receipt of consideration (IOWA CODE § 551A.4(1)(b))</td>
</tr>
<tr>
<td>Maryland</td>
<td>10 Business days before execution or receipt of consideration, copies to franchisee 14 days before execution (Md. BUS. REG § 14-114(b)(2))</td>
</tr>
<tr>
<td>Michigan</td>
<td>10 Business days before execution or receipt of consideration (MICH. COMP. LAWS § 445.1508(1))</td>
</tr>
<tr>
<td>Minnesota</td>
<td>7 days prior to execution or receipt of consideration <em>(which is overridden by the FTC 14 day rule)</em> (MINN. STAT. § 80C.06 Subd. 5)</td>
</tr>
<tr>
<td>New York</td>
<td>FDD must be given the earliest of: first personal meeting or 10 business days prior to execution or receipt of consideration (N.Y. GEN. BUS. LAW § 683(8))</td>
</tr>
</tbody>
</table>
## Attachment B
### Summary of State Deadlines for Updating FDD Upon Material Change

<table>
<thead>
<tr>
<th>States</th>
<th>Deadline for Amendment</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>Amendments must be made promptly upon the occurrence of any material change. (CAL. CORP. CODE § 31123)</td>
</tr>
<tr>
<td>Hawaii</td>
<td>Before any further sales of the franchise (HAW. REV. STAT. § 482E-3(b)).</td>
</tr>
<tr>
<td>Illinois</td>
<td>Amendments must be made within 30 days after the close of each fiscal quarter. (815 ILL. COMP. STAT. 705/11)</td>
</tr>
<tr>
<td>Indiana</td>
<td>N/A (No Amendment Filing Required)</td>
</tr>
<tr>
<td>Maryland</td>
<td>Amendments must be made promptly upon the occurrence of any material change. (MD. BUS. REG. § 14-220)</td>
</tr>
<tr>
<td>Michigan</td>
<td>You must promptly notify state in writing of any change in the information contained in the notice as originally submitted or amended. (MICH. COMP. LAWS § 445.1519)</td>
</tr>
<tr>
<td>Minnesota</td>
<td>Amendments must be filed within 30 days after the occurrence of any material change. (MINN. STAT. § 80C.07)</td>
</tr>
<tr>
<td>New York</td>
<td>Amendments must be made promptly upon the occurrence of any material change. (N.Y. GEN. BUS. LAW § 683.9)</td>
</tr>
<tr>
<td>North Dakota</td>
<td>Amendments must be made promptly upon the occurrence of any material change. (N.D. CENT. CODE ANN § 51-19-07(6)(a))</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>Amendments must be made promptly upon the occurrence of any material change. (R.I. GEN. LAWS § 19-28.1-11)</td>
</tr>
<tr>
<td>South Dakota</td>
<td>Amendments must be made within a reasonable time after the end of each quarter to reflect any material change. However, no filing with the division required. (S.D. CODIFIED LAWS § 37-5B-7(2))</td>
</tr>
<tr>
<td>Virginia</td>
<td>Within 30 days after the occurrence of a material change. (21 VA. ADMIN. CODE 5-110-40)</td>
</tr>
<tr>
<td>Washington</td>
<td>Amendments must be made as soon as reasonably possible after the occurrence of any material change, but in any case before any further franchise sales. (WASH. REV. CODE § 19.100.70(3))</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>Amendments must be made within 30 days after the occurrence of any material change. (Wis. STAT. § 553.31(1))</td>
</tr>
</tbody>
</table>
### Summary of Occurrences Constituting a Material Change Under State Law

<table>
<thead>
<tr>
<th>States</th>
<th>Occurrences</th>
</tr>
</thead>
</table>
| Hawaii (HAW. CODE R. §16-37-1) | - Termination, closing or failure to renew during any three-month period of: (a) the greater of 1% or 5 of all franchises in any location, or (b) the lesser of 15% or 2 of all franchises in Hawaii.  
- Any change in control, corporate name or state of incorporation, or reorganization of the franchisor.  
- Purchase by the franchisor in excess of 5% of its existing franchises during any three-month period.  
- Any new product, service, or model line involving, directly or indirectly, additional investment by any franchisee or the discontinuation or modification of the marketing plan or system of any product or service of the franchisor, where the total sales from such product or service exceed 20% of the gross sales of the franchisor on an annual basis. |
| Maryland (Md. CODE REGS. 02.02.08.01) | - Termination in any manner of more than 10% of the franchises located in Maryland in any three-month period.  
- Termination in any manner of more than 5% of all franchises regardless of location during any three-month period.  
- Reorganization of franchisor.  
- Change in control, corporate name, or state of incorporation of franchisor.  
- Any new product, service or model line requiring, directly or indirectly, additional investment by any franchisee.  
- Discontinuation or modification of the marketing plan or system of any product or service of the franchisor which accounts for at least 20% of the annual gross sales of the franchisor. |
| Minnesota (MINN. R. 2860.2400) | - Termination, closing, or failure to renew by the franchisor during any consecutive three-month period after registration of 10% of all franchises, regardless of location, or 10% of the franchises located in Minnesota.  
- Any change in control, corporate name, or state of incorporation, or reorganization of the franchisor.  
- The purchase by the franchisor during any consecutive three-month period after registration of 10% of its existing franchises, regardless of location, or 10% of its existing franchises in Minnesota.  
- Any new product, service, or model line involving, directly or indirectly, an additional investment in excess of 20% of the current average investment made by all franchises or the discontinuation or modification of the marketing plan or marketing system of any product or service of the franchisor where the average total sales from such product or service exceed 20% of the average gross sales of the existing franchisees on an annual basis.  
- Any change in the franchise fees charged by the franchisor.  
- Any significant change in: (1) the obligations of the franchisee to purchase items from the franchisor or its designated sources; (2) the limitations or restrictions on the goods or services which the |
<table>
<thead>
<tr>
<th>States</th>
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</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>franchisee may offer to a customer; (3) the obligations to be performed by the franchisor; or (4) the franchise contract or agreement, including all amendments thereto.</td>
</tr>
<tr>
<td>New York</td>
<td>• Termination, closing, or failure to renew; during a three month period, of the lesser of 10 or 10% of the franchises, regardless of location.</td>
</tr>
<tr>
<td></td>
<td>• Purchase by the franchisor in excess of 5% of its existing franchises during six consecutive months.</td>
</tr>
<tr>
<td></td>
<td>• A change in the franchise fees charged by the franchisor.</td>
</tr>
<tr>
<td></td>
<td>• Any significant adverse change in the business condition of the franchisor or in any of the following: (i) the obligations of the franchisee to purchase items from the franchisor or its designated sources; (ii) limitations or restrictions on the goods or services which the franchisee may offer to its customers; (iii) the obligations to be performed by the franchisor; (iv) the franchise contract or agreements, including amendments thereto; (v) the franchisor's accounting system resulting in a 5% or greater change in its net profit or loss in any six month period; or (vi) the service, product, or model line.</td>
</tr>
<tr>
<td></td>
<td>• Audited financial statements of the preceding fiscal year.</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>• Termination, closing or failure to renew during any three month period of 1) the greater of 1% or 5 of all franchises regardless of location, or 2) the lesser of 15% or 2 of the franchises of a franchisor located in Wisconsin.</td>
</tr>
<tr>
<td></td>
<td>• Any change in control, corporate name or state of incorporation, or reorganization of the franchisor.</td>
</tr>
<tr>
<td></td>
<td>• The purchase by the franchisor in excess of 5% of its existing franchises during any three-month period on a running basis.</td>
</tr>
<tr>
<td></td>
<td>• Any new product service or model line involving, directly or indirectly, additional investment by any franchisee or the discontinuation or modification of the marketing plan or system of any product or service of the franchisor where the total sales from such product or service exceeds 20% of the gross sales of the franchisor on an annual basis.</td>
</tr>
<tr>
<td></td>
<td>• An adverse financial development involving the franchisor or the franchisor's parent company, controlling person or guarantor of the franchisor's obligation, including: (1) the filing of a petition under federal or state bankruptcy or receivership laws; or (2) a default in payment of principal, interest, or sinking fund installment on indebtedness that exceeds 5% of total assets which is not cured within 30 days.</td>
</tr>
</tbody>
</table>
### State Advertising Requirements

<table>
<thead>
<tr>
<th>State</th>
<th>No. of Copies to File</th>
<th>Time to File Before Use</th>
<th>Selected Restrictions</th>
</tr>
</thead>
</table>
| California    | 2                    | 3 business days         | Any advertisement of a franchise should disclose fairly and accurately such relevant facts concerning the franchise, the terms and conditions thereof and the material rights and liabilities created thereunder as are necessary to make the advertisement not misleading. Normally, an advertisement should also comply with the following standards:  
(a) An advertisement should not contain any statement or inference that a purchase of a franchise is a safe investment or that failure, loss or default is impossible or unlikely, or that earnings or profits are assured;  
(b) Earnings claims must conform with Item 19 of the offering circular prescribed by the Uniform Franchise Registration Application.  
(c) Any advertisement which refers to the registration of the franchise in California shall contain in capital letters of not less than 10-point type the following:  
"THESE FRANCHISES HAVE BEEN REGISTERED UNDER THE FRANCHISE INVESTMENT LAW OF THE STATE OF CALIFORNIA. SUCH REGISTRATION DOES NOT CONSTITUTE APPROVAL, RECOMMENDATION OR ENDORSEMENT BY THE COMMISSIONER OF CORPORATIONS NOR A FINDING BY THE COMMISSIONER THAT THE INFORMATION PROVIDED HEREIN IS TRUE, COMPLETE AND NOT MISLEADING."  
(d) An advertisement should normally contain the name and address of the person using the advertisement.  
(e) If the advertisement contains any endorsement or recommendation of the franchises by any public figure, whether express or implied (for example, by inclusion of such person’s photograph or name in the advertisement), full disclosure shall be made of any compensation or other benefit given or promised by the franchisor or any person associated with the franchisor to such person, directly or indirectly. The disclosure required in this Subsection (e) shall be made in the same document containing the advertisement or, if such advertisement is presented on radio or television, as a part of the same program, without any intermission or other intervening material.  
(f) Any advertisement which refers to an exemption from or reduction in taxation under any law should be based on an opinion of counsel, and the name of such counsel should be stated in the advertisement.  

Internet advertisements are exempt from advertising filing requirements provided the franchisor files the requisite written notice, the advertisement is not directed to any person in the State of California, and the FDD contains the following language in not less than 12-point size:  
"OUR WEBSITE HAS NOT BEEN REVIEWED OR APPROVED BY THE CALIFORNIA DEPARTMENT OF BUSINESS OVERSIGHT. ANY COMPLAINTS CONCERNING THE CONTENT OF THIS WEBSITE MAY BE DIRECTED TO THE CALIFORNIA DEPARTMENT OF BUSINESS OVERSIGHT at www.dbo.ca.gov."
<table>
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</tr>
</thead>
<tbody>
<tr>
<td>Maryland</td>
<td>1</td>
<td>5 calendar days</td>
<td>An advertisement for a franchise offering may not refer to: (a) The purchase or sale of a franchise as a safe investment, as free from risk of loss or default, or as a guarantee or assurance of earnings or profits; (b) An earnings claim, unless otherwise permitted by the Commissioner; or (c) An opinion of counsel without stating the name and address of the counsel.</td>
</tr>
<tr>
<td>Md. Code Regs.</td>
<td></td>
<td></td>
<td>Advertising shall state the name and address of the person sponsoring the advertisement or making the offer.                                                                ---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>02.02.08.09</td>
<td></td>
<td></td>
<td>Advertising submitted under this regulation that is in the form of videotapes or audiotapes shall be accompanied by a written transcript and description of the contents.</td>
</tr>
<tr>
<td>Minnesota</td>
<td>1</td>
<td>5 business days</td>
<td>No advertisement shall make reference to: A. the acquiring of a franchise as an assurance of earnings or profits, as a safe investment, or as free from any loss, default, or failure or that such is impossible or unlikely; B. projections or statements of operations of or income from the operation of any franchise; or C. any opinion of counsel without stating the name and address of such counsel.</td>
</tr>
<tr>
<td>Minn. R. 2860.4100</td>
<td></td>
<td></td>
<td>All advertisements must contain the name and address of the person using the advertisement or making the offer, including the name or the primary commercial symbol of the franchisor, and the registration number assigned to the offering by the commissioner.</td>
</tr>
<tr>
<td>New York</td>
<td>2</td>
<td>7 calendar days</td>
<td>(d) All sales literature in connection with franchise offerings shall contain the following statement in easily readable print, except as provided herein: “This advertisement is not an offering. An offering can only be made by a prospectus filed first with the Department of Law of the State of New York. Such filing does not constitute approval by the Department of Law.”</td>
</tr>
<tr>
<td>N.Y. Comp. codes R. &amp; Regs., Tit. 13 § 200.09</td>
<td></td>
<td></td>
<td>(e) The statement required under the foregoing subdivision shall similarly be contained in on the cover page of all circulars, flyers, cards, letters and other literature employed in connection with soliciting interests in the franchise offering.</td>
</tr>
<tr>
<td>North Dakota</td>
<td>1</td>
<td>5</td>
<td>Must not contain any statement that is false or misleading or omits to                                                                -------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
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</tr>
<tr>
<td>N.D. CENT. CODE ANN § 51-19-10.2</td>
<td></td>
<td>business days</td>
<td>make any statement necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.</td>
</tr>
<tr>
<td>Rhode Island R.I. GEN. LAWS §19-28.1-13</td>
<td>N/A</td>
<td>N/A</td>
<td>Franchisors must maintain the advertising materials for five (5) years and must be maintained consistent to the requirements of Rhode Island Franchise Investment Act.</td>
</tr>
</tbody>
</table>
| Washington WASH. ADMIN. CODE § 460-80-510 | 1 | 7 calendar days | All advertising to be used to offer a franchise … shall be subject to the following statement of policy:  
(1) An advertisement should not contain any statement or inference that a purchase of a franchise is a safe investment or that failure, loss or default is impossible or unlikely, or that earnings or profits are assured. 
(2) An advertisement should not normally contain a projection of future franchisee earnings unless such projection is (a) based on past earnings records of all franchisees operating under conditions, including location, substantially similar to conditions affecting franchises being offered (b) for a reasonable period only and (c) is substantiated by data which clearly supports such projections. 
(3) An advertisement should normally contain the name and address of the person using the advertisement. 
(4) If the advertisement contains any endorsement or recommendation of the franchises by any public figure, whether express or implied (for example, by the inclusion of such person’s photograph or name in the advertisement), full disclosure shall be made of any compensation or other benefit given or promised by the franchisor or any person associated with the franchisor to such person, directly or indirectly. The disclosure required in this Subsection shall be made in the same document containing the advertisement or, if such advertisement is presented on radio or television, as a part of the same program, without any intermission or other intervening material. 
(5) Any advertisement which refers to an exemption from or reduction in taxation under any law should be based on an opinion of counsel, and the name of such counsel should be stated in the advertisement. |
<table>
<thead>
<tr>
<th>State &amp; Citation</th>
<th>Response from Franchisor</th>
<th>Prohibitions</th>
</tr>
</thead>
</table>
| Arkansas
ARK. CODE §§ 4-72-205(b)(1)-(2) | Within 60 days of notice from franchisee (or deemed approved); must include reasons for disapproval. | None |
| California
CAL. BUS. & PROF. CODE § 20027 | None | After death of franchisee or majority owner, the surviving spouse, heirs or estate have a right to participate in the franchised business for a reasonable time, but survivor must satisfy all qualifications to act as franchisee within that time period. |
| Hawaii
HAW. REV. STAT. §§ 482E-6(2)(I)(i)-(iv) | Within 30 days after notice from franchisee (or deemed approved); must include reasons for disapproval. | No disapproval without good cause, which includes (i) proposed buyer failing to meet reasonable qualifications or standards, (ii) transferee is a competitor, (iii) transferee refuses to agree to comply with lawful obligations imposed by franchisor, including signing a new form of franchise agreement, or (iv) franchisee or transferee fail to pay franchisor any sums owed or cure any defaults under any agreement. |
| Indiana
IND. CODE § 23-2-2.7-2(3); | None | After death of franchisee or majority owner, the surviving spouse, heirs or estate have a right to participate in the franchised business for a reasonable time, but survivor must satisfy all qualifications to act as franchisee within that time period. |
| Iowa
IOWA CODE § 523H.5 | Within 60 days of notice from franchisee (or deemed approved). | No disapproval if transferee satisfied reasonable current qualifications, based on legitimate business reasons (not arbitrary or capricious). Franchisor may not require transferee to enter into new franchise agreement. No discrimination on basis of race, color, national origin, religion, sex or disability. |
| Michigan
MICH. COMP. LAWS § 445.1527(g) | None | No disapproval without good cause, which includes (i) proposed buyer failing to meet reasonable qualifications or standards, (ii) transferee is a competitor, (iii) transferee refuses to agree to comply with lawful obligations, or (iv) franchisee or transferee fail to pay franchisor any sums owed, or cure any defaults under franchise agreement. |
| Minnesota
MINN. R. 2860.4400(H) | None | Franchisor cannot unreasonably withhold its consent if proposed transferee meets current qualifications and standards. |
| Nebraska
NEB. REV. STAT. § 87-405 | Within 60 days of notice from franchisee (or deemed approved); must include reasons | None |
<table>
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<th>Response from Franchisor</th>
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</tr>
</thead>
<tbody>
<tr>
<td>New Jersey</td>
<td>Within 60 days of notice from franchisee (or deemed approved); must include reasons for disapproval.</td>
<td>None</td>
</tr>
<tr>
<td>N.J. STAT. § 56:10-6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Washington</td>
<td>None</td>
<td>Franchisor must approve or disapprove the transfer in a reasonable manner. Restrictions on transfer may only be imposed in a reasonable manner. Transfer fees are only permissible to the extent they compensate franchisors for their expenses. General releases of claims cannot contain a release of claims under the WA Franchise Investment Protection Act.</td>
</tr>
<tr>
<td>WASH. REV. CODE §19.100.030(1); 19.100.180(2)(g)</td>
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</tr>
</tbody>
</table>
## Summary of State-Required Default and Termination Restrictions

<table>
<thead>
<tr>
<th>States</th>
<th>Cause for Termination</th>
<th>Notice/Cure Period</th>
<th>Buy-Back by Franchisor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arkansas</td>
<td>Termination requires “good cause”, which includes: (i) failure to comply with non-discriminatory requirements; (ii) failure to act in good faith and in a commercially reasonable manner; (iii) voluntary abandonment; (iv) convicted of a crime related to franchised business with a sentence longer than a year; (v) conduct substantially impairing the trademark or name; (vi) insolvency or bankruptcy; (vii) loss of right to occupy premises; (ix) failure to pay sums past due within 10 days of notice.</td>
<td>Termination requires 90 days written notice explaining basis of termination and a 30 day cure period unless the basis is for repeated infractions within 12 months, then only a 10 day cure period. No notice required if termination for causes listed in (iii)-(ix) in definition of “good cause”.</td>
<td>N/A</td>
</tr>
<tr>
<td>Arkansas</td>
<td>ARK. CODE §§ 4-72-202, 4-72-204</td>
<td></td>
<td></td>
</tr>
<tr>
<td>California</td>
<td>Termination requires “good cause” unless the franchise agreement is of infinite duration. “Good cause” is limited to the failure to substantially comply with lawful requirements imposed by the franchise agreement, after the applicable cure period.</td>
<td>For franchise agreements entered into or renewed on or after Jan. 1, 2016, terminations for “good cause” require 60 days advance notice, and a cure period between 60 and 75 days from the date of notice. For any other franchise agreement, terminations made for “good cause” may be effected after giving notice and a reasonable opportunity to cure, which need not exceed 30 days. Terminations are effective immediately on notice, without opportunity to cure, for: (i) bankruptcy or insolvency; (ii) abandonment or failure to operate; (iii) by mutual agreement; (iv) misrepresentation in acquiring the franchise or conduct that materially negatively affects the franchise system; (v) noncompliance after 10 days’ notice; (vi) repeated noncompliance; (vii) involuntary loss of premises; (viii) criminal conviction related to franchise operation; (ix) failure to pay sums due within 5 days of notice; (x) imminent danger to public health or safety. All notice must be in writing, delivered personally to franchisee, and contain statement of intent to terminate, basis of termination, and termination date.</td>
<td>N/A</td>
</tr>
<tr>
<td>Connecticut</td>
<td>Termination requires “good cause”, which includes without</td>
<td>Termination requires (i) 60 days written notice that states the basis for</td>
<td>Upon termination the franchisor must fairly and</td>
</tr>
<tr>
<td></td>
<td></td>
<td>upon termination the franchisor must fairly and</td>
<td></td>
</tr>
<tr>
<td>States</td>
<td>Cause for Termination</td>
<td>Notice/Cure Period</td>
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</tr>
<tr>
<td>CONN. GEN.</td>
<td>limitation, substantial noncompliance with the franchise agreement.</td>
<td>termination, (ii) 30 days written notice if the franchisee voluntarily abandons, or (iii) immediately upon notice if franchisee is convicted of a crime related to franchised business with a sentence longer than a year. If franchise is on premises leased by the franchisor to franchisee, notice must be served by neutral party and state the lease will terminate and the franchisee may have certain rights under the Connecticut Franchises Law.</td>
<td>reasonably compensate the franchisee for inventory, supplies, equipment, and furnishings.</td>
</tr>
<tr>
<td>DEL. CODE §§ 2552, 2555</td>
<td>Termination must be for good cause and not in bad faith.</td>
<td>Termination requires 90 days written notice.</td>
<td>N/A</td>
</tr>
<tr>
<td>Delaware</td>
<td>Termination either (i) requires good cause, which includes, but is not limited to, the failure to comply with any lawful material provision of the franchise agreement after reasonable notice and opportunity to cure; or (ii) may be done in accordance with the current reasonable terms and standards as equally applied to all franchisees, with the burden to prove differing terms between franchises is not arbitrary.</td>
<td>N/A</td>
<td>Upon termination the franchisor must compensate the franchisee at fair market value for inventory, supplies, equipment, and furnishings.</td>
</tr>
<tr>
<td>Hawaii</td>
<td>Termination must be for good cause, which includes the failure to comply with any lawful provision of the franchise agreement.</td>
<td>Termination requires a 30 day opportunity to cure, except that no cure period is required if the termination is due to (i) an assignment for the benefit of creditors, (ii) voluntary abandonment, (iii) conviction of a felony or crime that substantially impairs the goodwill associated with the trademarks, service marks, trade names, or commercial symbols; or (iv) repeated noncompliance with agreements.</td>
<td>N/A</td>
</tr>
<tr>
<td>Illinois</td>
<td>Termination must be for good cause and not in bad faith. Good cause includes any material violation of the franchise agreement.</td>
<td>Termination requires written notice (unless otherwise provided in the franchise agreement).</td>
<td>N/A</td>
</tr>
<tr>
<td>Iowa</td>
<td>Termination requires good cause based upon a legitimate business reason, including noncompliance with any material lawful requirement of the franchise agreement, and may</td>
<td>Termination requires written notice stating basis for termination, with a minimum of a 30 day cure period, and in any event no longer than 90 days, unless the termination is due to nonpayment of amounts due, which</td>
<td>N/A</td>
</tr>
<tr>
<td>States</td>
<td>Cause for Termination</td>
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</tr>
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</tr>
<tr>
<td>Michigan</td>
<td>Termination requires good cause, which includes the failure to comply with any lawful provision of the franchise agreement.</td>
<td>Termination requires 30 days’ notice to cure.</td>
<td>N/A</td>
</tr>
<tr>
<td>Minnesota</td>
<td>Termination requires good cause, which means the failure to substantially comply with material and reasonable terms that include: (i) bankruptcy or insolvency; (ii) assignment for the benefit of a creditor; (iii) voluntary abandonment; (iv) conviction of a crime related to the franchise; and (v) any act materially impairing the goodwill, trademark, or other commercial symbol.</td>
<td>Termination requires 90 days written notice stating basis for termination and a 60 day cure period. Termination is effective upon notice if good cause exists under (iii) – (v) in definition.</td>
<td>N/A</td>
</tr>
<tr>
<td>Mississippi</td>
<td>N/A</td>
<td>Requires 90 days written notice, unless termination is for: (i) criminal misconduct, (ii) fraud, (iii) abandonment, (iv) bankruptcy or insolvency, (v) lack of account or insufficient funds.</td>
<td>N/A</td>
</tr>
<tr>
<td>Missouri</td>
<td>N/A</td>
<td>Requires 90 days written notice, unless termination is for: (i) criminal misconduct, (ii) fraud, (iii) abandonment, (iv) bankruptcy or insolvency, (v) lack of account or insufficient funds.</td>
<td>N/A</td>
</tr>
<tr>
<td>Nebraska</td>
<td>Termination must be for good cause, which is limited to</td>
<td>Termination requires 60 days written notice, but only 15 days written notice</td>
<td>N/A</td>
</tr>
<tr>
<td>States</td>
<td>Cause for Termination</td>
<td>Notice/Cure Period</td>
<td>Buy-Back by Franchisor</td>
</tr>
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<td>------------------------------------------------------------------------------------</td>
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</tr>
<tr>
<td>Nebraska</td>
<td>failures to substantially comply with requirements of franchise agreement.</td>
<td>of termination is based on voluntary abandonment.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Termination is effective immediately upon written notice for: (i) conviction related to franchise; (ii) bankruptcy or insolvency; (iii) default in payments or failure to account for sales of goods; (iv) falsification of records or reports; (v) imminent danger to public health or safety; (vi) loss of right to occupy premises.</td>
<td></td>
</tr>
<tr>
<td>New Jersey</td>
<td>Termination must be for good cause, which is limited to failures to substantially comply with requirements.</td>
<td>Termination requires 60 days written notice, or only 15 days written notice of termination is based on abandonment. Termination is effective immediately upon written notice of a felony conviction related to the franchise.</td>
<td>N/A</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>Termination requires good cause, including: (i) failure to comply with reasonable requirements; (ii) voluntary abandonment; (iii) felony conviction related to the franchise; (iv) substantial action impairing goodwill, trade name, trademark, service mark, or commercial symbols; (v) material misrepresentation relating to franchise; (vi) unauthorized transfer; (vii) insolvency or bankruptcy; and (viii) assignment for the benefit of creditors.</td>
<td>Termination requires 60 days written notice stating basis for termination, or with a 30 day cure period, is required for terminations for failure to comply with reasonable requirements, provided franchisee has had the right to cure 3 times in any annual period. Termination is effective immediately upon written notice for (ii) – (viii) in definition of “good cause”. Termination based on nonpayment requires a 10 day cure period after written notice, provided franchisee has had the right to cure 3 times in any annual period. Termination based on violations of public health or safety, requires a 24 cure period after written notice.</td>
<td>Franchisor, at the option of franchisee, must repurchase all inventory at the fair, wholesale market value.</td>
</tr>
<tr>
<td>Virginia</td>
<td>Termination requires reasonable cause to terminate, but the franchisor may not use undue influence to induce the franchisee to surrender any right given by the franchise agreement.</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Washington</td>
<td>Termination requires good cause, which includes the failure of the franchisee to comply with any lawful material provision of the franchise agreement.</td>
<td>Termination requires written notice and a 30 day opportunity to cure. If not cured within this 30 days or the failure is not curable within 30 days, franchisee must initiate substantial continuing action to cure within 30 days, Termination is effective immediately without notice if: (i) willfully breaches a 4th time in 12 months after failing to cure prior incidents that received</td>
<td>Franchisor must purchase inventory and supplies at fair market value at the time of termination, excluding personalized materials, inventory or supplies not required for the franchise, and inventory and supplies not purchased from the franchisor or by express requirement if the</td>
</tr>
<tr>
<td>States</td>
<td>Cause for Termination</td>
<td>Notice/Cure Period</td>
<td>Buy-Back by Franchisor</td>
</tr>
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<tr>
<td>Wisconsin</td>
<td>Termination requires good cause, which means the failure to comply substantially with</td>
<td>Termination under good cause requires 90 days written notice stating the basis for termination and a 60 day cure period.</td>
<td>Franchisor, at the option of franchisee, must repurchase all inventory at the fair, wholesale market value.</td>
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<td>WIS. STAT. §§ 135.02 – 135.045</td>
<td>essential, reasonable, and non-discriminatory requirements, or act in bad faith in carrying out the terms of the franchise.</td>
<td>Termination is effective immediately for bankruptcy, insolvency, or an assignment for the benefit of creditors. Termination for nonpayment of amounts due requires 90 days written notice and a 10 day cure period.</td>
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<td>Puerto Rico</td>
<td>Termination only requires just cause, which means the nonperformance of any of the</td>
<td>N/A</td>
<td>N/A</td>
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<td>P.R. LAWS 10 §§ 278 – 278a-1</td>
<td>franchise agreement's essential obligations, or any action or omission that adversely and substantially affects the interests of the franchisor in promoting the merchandise or service of the franchise. Unless nonperformance may adversely affect or has affected the franchisor's interest, &quot;just cause&quot; does not include violations of a franchise agreement due to (i) changes to the capital structure of the franchisee business; (ii) changes to the managerial control; (iii) the manner or form of financing of the franchisee business; (iv) the free sale, transfer or encumbrance of any corporate action, participation, right or interest that any person could have; and (v) fixing rules of conduct or distribution quotas if such violation does not take into account the realities of the Puerto Rican market at the time of violation.</td>
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<tr>
<td>Virgin Islands</td>
<td>Termination must be for good cause, which includes the failure to substantially comply with the essential and reasonable requirements of the franchise agreement and bad faith in carry</td>
<td>Termination requires 120 days prior written notice.</td>
<td>N/A</td>
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<tr>
<td>States</td>
<td>Cause for Termination</td>
<td>Notice/Cure Period</td>
<td>Buy-Back by Franchisor</td>
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<td>out the franchise agreement.</td>
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Attachment G

Outside Counsel Billing Policies

FEES FOR SERVICES

a) In matters that are to be billed based on the law firm’s hourly rates, Company and outside counsel shall, prior to engagement, agree on a schedule showing the billing rate for each timekeeper (or class of timekeeper) assigned to the engagement. Once agreed upon at the commencement of a matter, the scheduled billing rates shall remain in effect for the duration of the engagement unless key Company approves in writing proposed rate changes in advance. In no event will rate changes be more than an annual cost of living adjustment and such rate changes must be applicable to all other clients of outside counsel. Outside counsel shall provide Company with at least thirty (30) days advance written notice of any increase in rates. Company expects to be billed at rates that are highly competitive with those of comparable firms providing comparable services to Company or other similar clients. In addition, Company expects that outside counsel will charge for services at net billing rates which represent a discount to the standard rates charged by the firm.

b) When billing on an hourly basis, billing increments of 0.10 hours (six minutes) are the minimum.

c) Unless Company approves different arrangements in writing, invoices should be submitted monthly, within thirty (30) days after the end of the month in which the services were rendered. Except for very minor matters, each engagement should be invoiced as a separate matter and not as “miscellaneous” or “general.”

d) Each invoice should contain a detailed itemization of each service provided with the specific date of service, the identity of the authorized person who provided the service, the amount of time spent in providing the service, a description of the work performed, the Company employee the work was provided for and the amount charged for the service. Block billing will not be accepted. Where more than one professional is involved in the same work project – such as writing a brief or attending a meeting or a deposition – the details in the invoice should make it clear why the other person or persons’ presence was necessary. A summary by each professional providing services during that billing period, showing (i) the total time spent by that professional, (ii) the billing rate for that professional, (iii) the position of that professional, and (iv) the total charges for that professional should be included. Total fees and disbursements year-to-date on the matter as well as total fees and disbursements from the inception of the case to date should be included on each invoice.

e) Company must approve each attorney assigned to work on Company matters. No more than two (2) attorneys should work on a particular matter without the prior approval of Company Counsel.

f) Unless prior approval has been given, Company will not pay for more than one representative of outside counsel at meetings, court appearances, hearings, depositions, etc.

g) If intra-office conferences of outside counsel are required for effective representation (other than a brief conference to allocate work responsibilities), the detailed description in the billing statement must list all persons present and the subject matter. Ordinarily, unless specific prior approval has been given by Company, billing for extended intra-
office conferences is expected to be limited to a single charge for the time spent by the conference participant with the highest authorized billing rate.

h) Attorney travel time outside the metropolitan area in which outside counsel is located should be charged at no more than 50% of the hourly rate charged to Company, whenever charges are based on billable hours. If legal services are billed for services or work performed during travel time, travel time billing should be reduced accordingly.

i) Time devoted to preparation of bills, including accompanying cover letters, should not be included.

j) Time devoted by an attorney to become familiar with a file due to a prior attorney leaving or joining outside counsel’s firm must not be billed to Company.

k) Outside counsel shall not contact Company employees, other than members of the Company legal Department without prior approval of in-house counsel.

l) Prior to undertaking any major activity, including legal research of more than two (2) hours duration, outside counsel is expected to consult with in-house counsel responsible for the matter.

m) Estimates of fees and expenditures must be submitted to the referring in-house attorney. Outside counsel are expected to work within the estimates submitted. If it is anticipated that the estimates will be exceeded, outside counsel will contact the in-house attorney to discuss and resolve the deviation.

n) Outside counsel are expected to forward to in-house counsel all memoranda of fact or law, correspondence, drafts and final forms of pleadings, and other work product pertaining to the matter for which outside counsel was engaged.

EXPENSES

All costs and disbursements must be itemized and reflect actual out-of-pocket costs with no mark-up or administrative fees. Costs listed as “miscellaneous” will not be paid.

Without prior written approval, the following out-of-pocket expenses are not acceptable and will not be paid:

a) standard minimum charges or "flat charges" (for example, "opening file," “closing file,” “organization of file”);

b) secretarial or clerical overtime (unless occasioned by an emergency situation created by Company);

c) charges for word processing, internet access or computer time (except actual charges for on-line computer research authorized under these Guidelines);

d) charges for WestLaw or LexisNexis research;

e) markups or administrative surcharges on supplies or services procured from third parties;

f) charges for photocopying ;

g) charges for local meals or taxis;

h) volume copying done by outside vendors;
i) charges for faxes except for long distance telephone charges actually levied for outgoing faxes;

j) temporary support personnel; and

k) courier service charges (i.e. messenger services, overnight delivery – FedEx, UPS, etc.).

l) Company will only reimburse outside counsel for reasonable travel expenses incurred provided that such expenses are incurred pursuant to Company’s Travel Policy, (ii) supported by adequate documentation, (iii) outside counsel has first obtained the CFO’s prior written approval before incurring such expense, Company expects outside counsel to use commercially reasonable efforts to make all travel arrangements through Company’s approved travel vendors and to make all travel arrangements at the lowest commercially available rates available for the specific dates and time that travel is required. Outside counsel shall itemize travel expenses on the fee statements. Company will reimburse only for coach or economy-class air fare. When selecting ground transportation and hotel accommodations, outside counsel should consider cost and ease of access to the business destination. Travel by personal automobile will be reimbursed at the rate per mile currently authorized as deductible by the Internal Revenue Service.

Outside counsel is expected to use the least costly method of communication appropriate to the circumstances.

Prior to the retention of any additional service provider such as an expert, consultant, or other law firm, the curriculum vitae and fee schedule of such person must be submitted to Company and approval obtained. Bills from expert witnesses and consultants may be included with the statement of outside counsel, or sent separately to Company. All such bills should following these billing guidelines and include the person's or firm's tax identification number.
Antonia Scholz is a partner at Cheng Cohen LLC located in Chicago, Illinois. Antonia’s practice focuses on franchise and licensing law, mergers and acquisitions, commercial contracts, private equity financing, and other general corporate matters. She represents franchise companies of all development stages, from industries as diverse as pet-care, fitness, restaurants, and retail. She has extensive experience guiding emerging brands through the complexities of developing a franchise program and provides sophisticated ongoing support to companies of all sizes through every step of growth. Antonia also has significant general corporate and transactional experience in matters such as mergers and acquisitions, private equity, and corporate restructuring. Antonia has been a member of the Forum since 2012, previously serving as the Young Lawyer’s Division Liaison to the Forum’s Governing Committee, and currently serving as a member of the Forum’s Membership Committee. Antonia is also a member of the International Franchise Association, including by serving as a member of the IFA’s Women’s Franchise Committee and a Co-Chair of the IFA’s Women’s Franchise Network (Chicago Chapter). Prior to joining Cheng Cohen, Antonia practiced at Drinker, Biddle & Reath, LLP in Chicago, where her practice focused on mergers and acquisitions, securities and governance, commercial finance and general corporate matters. Antonia earned her law degree from The University of Chicago Law School.
Mike Coccaro is the General Counsel for SYNERGY HomeCare, a national franchisor providing non-medical in-home care. Prior to joining SYNERGY HomeCare, Mike worked at Snell & Wilmer, L.L.P. in Phoenix, Arizona on franchise matters. Mike earned his J.D. from the University of Washington School of Law in 2007. Mike began practicing franchise law at the Phoenix office of Snell & Wilmer, L.L.P. and worked there for seven years before accepting the position of General Counsel for SYNERGY HomeCare. As General Counsel, Mike oversees the legal affairs of SYNERGY HomeCare and serves on its Executive Team.
Cheryl Mullin is the founding shareholder of Mullin Law, PC. Her practice focuses on assisting commercial clients achieve their growth objectives through franchising, joint ventures, acquisition, and private investment. She also provide intellectual property protection services to small and mid-size enterprises, business transition planning services for closely-held businesses, and commercial litigation support on business issues. Cheryl earned her J.D. from Widener University School of Law in 1995, and her LL.M (Taxation) from Southern Methodist University Dedman School of Law in 2013. She is recognized for her work in franchising by International Who’s Who of Franchise Lawyers, Texas Super Lawyers, and Best Lawyers in America. Cheryl also has been recognized since 2007 by “D” Magazine as one of the best lawyers in Dallas, and by Franchise Times magazine since 2004 as a “Legal Eagle.” Cheryl lectures frequently on corporate and franchise-related topics, and is AV-rated by Martindale-Hubbell.