ADVANCED ISSUES IN FRANCHISOR ACQUISITIONS OF FRANCHISEES -

IS VERTICAL INTEGRATION IN YOUR FUTURE?

Joel R. Buckberg
Baker Donelson Bearman Caldwell & Berkowitz, PC
Nashville, Tennessee

Emily Decker
Buffalo Wild Wings, LLC
Minneapolis, Minnesota

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Attachment B

Table of Contents

I. Introduction

II. Transaction Structures

III. Letters of Intent
   A. Fully Enforceable
   B. Preliminary Agreement to Negotiate in Good Faith

IV. Deal Points
   A. Exclusivity
   B. Representations and Warranties
      1. Misrepresentation and Fraud
      2. Breach of Express Warranty
      3. Sandbagging/Anti-Sandbagging
   C. Indemnification
   D. Holdbacks and Offsets
   E. Material Adverse Changes Before Closing
   F. Representation and Warranty Insurance
      1. Background
      2. The Advantages of R & W Insurance
      3. Types of Policies
      4. Key Policy Terms
      5. Exclusions and Retention
      6. Premiums and Dispute Resolution
      7. Insurer Selection and Underwriting Process
V. Additional Due Diligence Issues

A. State Tax Issues
   1. State Enterprise Taxation
   2. Local Tax Compliance

B. Federal Tax Audit Changes in 2018

C. Predictive Coding

VI. How to Value the Deal

VII. Franchisor Right of First Refusal

A. Early Franchisor Involvement in a Proposed Transfer
   1. Marketing Materials Review
   2. Transfer Requirements
   3. What is for Sale?

B. Right of First Refusal Process
   1. Notifying the Franchisor of a Proposed Transfer
   2. What Triggers the Right of First Refusal Process?
   3. Additional Diligence Required
   4. Analysis
   5. Approval of New Franchisee

C. Exercising the Right of First Refusal
   1. Adjusting the Purchase Agreement To Be Relevant For A Franchisor Purchase
   2. Closing the Deal

VIII. Conclusion

Exhibit A - Representations and Warranties
Exhibit B - Transfer Information and Process
I. Introduction

The legal representation of parties acquiring and selling franchisors has been the focus of a number of prior articles and books published by the ABA Forum on Franchising. The authors note that the franchise marketplace has witnessed a different transactional genotype, the acquisition of a single or multi-unit franchisee or developer by the franchisor or an affiliate. This activity is sometimes called "defranchising," as the census of franchises disclosed in Item 20 of the franchisor's Franchise Disclosure Document declines and the number of franchisor and affiliate-owned units increases. The opposite term, "refranchising," refers to the sale of company and affiliate-owned units to franchisees with the opposite impact on the Item 20 disclosure, an increase in the number of franchised units and a decrease in the number of company and affiliate-owned units.

What market place trends are driving this phenomenon? Most franchisees have an exit strategy when they buy a franchise. Like any other long term investment, the buyer usually has a specific holding period in mind, which may be shorter than the term of the financing secured by the franchised business. At the end of the holding period, who are the logical buyers? Traditionally, buyers were the next generation of the franchisee principal's family, another franchisee or a new entrant to the brand unwilling to take the development risk of a de novo franchise. If the franchisee is not troubled or facing a financing end point, why would the franchisor or an affiliate buy the franchised outlet or business from the franchisee?

From the purely financial perspective, the answer lies in valuation differential. Simply put, the discounted cash flow from a family or privately owned business that is not heavily burdened by non-cash charges like depreciation and amortization has less value than the same cash flow owned by a business that is either publicly traded or private equity owned. There are substantial valuation discounts for the lack of a public market, for the illiquidity of privately held ownership and for businesses that are run to maximize after tax cash flow rather than book earnings for accounting purposes. For this reason, until capital market conditions flip this calculus, franchisees with good cash flow or improvable cash flow and modest capital investment will make attractive candidates for franchisor or affiliate purchase. This is particularly true when the supply of equity capital for franchisors is strong, their cost of capital is relatively low, and interest rates are low. That is not to say that franchisors pay a premium for franchisee outlets. Approval rights of the transferee and rights of first refusal retained by the franchisor actually cause discounts for their pricing of franchisees. Based on these macroeconomic and structural factors, recently observed trends of defranchising may continue until interest rates rise and the supply of capital to franchisors contracts.

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1 The authors wish to thank Hunter Threet, a law student at the University of Tennessee School of Law, for his assistance with the research for this paper.


Franchisor acquisitions of franchised outlets can be grouped into at least three categories that affect the structure and legal issues faced by counsel. The first category is the "Owner/Operator Purchase," defined here as the purchase of one or more outlets from a single franchisee that owns and operates the outlets in a single market area, with no "inchoate development rights or obligations." The seller's administrative function supports only the units being sold and the operation of the enterprise will wind down after the sale. The concept of inchoate development rights or obligations for our purposes means contractual rights granted to the franchisee to develop new outlets either on an exclusive basis in a defined geographic area, on a basis that includes discounted initial or on-going fees, or on some other economically beneficial basis, or some combination thereof that carries economic value for the franchisee. Later we will discuss how a franchisor may deal with the issue of making these rights transferable.

The second category is the "Multi-Market Purchase," defined as the purchase of one or more outlets from a single franchisee or affiliated group of franchisees in one or more markets where the franchisee/developer has rights to develop outlets that have not yet been exercised. The Multi-Market Purchase seller is part of a larger enterprise with integrated administrative functions rather than functions dedicated to the outlets being sold. The seller's business will continue to operate after the sale. The outlet managers will likely stay in place but higher level supervisors and support functions will remain with the seller.

The third category is the "Financial Seller Purchase," defined as the sale of ownership of franchised outlets, possibly including inchoate development rights, where the seller is a private equity or similar institutional investor that does not participate in operations. Management is likely to remain in place or receive substantial compensation if they are displaced by the change of control. This last category is a more recent phenomenon, as private equity and institutional interest has expanded to large franchisee enterprises. The seller or investor most likely has a broad relationship agreement with the franchisor governing sale of the outlets or the equity of the entities that own and operate the franchises, among other things, under which such a transaction may be contemplated in advance.

This topic justifies a treatise. This paper focuses on certain key issues and considerations unique to franchisor/franchisee acquisition transactions.

II. Transaction Structures

Any business acquisition has an essential structure to be determined and general tenets of transactional structure to be established by the parties. When the parties express an interest in considering an ad hoc purchase and sale transaction, initially they will most likely exchange a confidentiality agreement or non-disclosure and non-use agreement. The franchise agreement and related agreements already have a defined flow of routine information, audit and inspection rights in favor of the franchisor, and remote data access rights so the franchisor often can access the point of sale and back office accounting systems of the franchisee remotely to poll data and interrogate transaction history.

Franchisees are also likely obligated to maintain books and records in a prescribed format, use a standard chart of accounts and provide financial statements and key performance indicator data to the franchisor on a periodic basis. Whether the franchisee target has complied with its recordkeeping obligations and the data flow to the franchisor has been as robust as the contracts contemplate is a fact question in each situation. For these reasons, franchisors may wish to assemble what data is available without asking the franchisee, and then create a list of
what gaps exist. In this era of constrained oversight of franchisee human resource issues, the largest information gap will likely be that aspect of the franchisee's business. The franchisee is likely to request a confidentiality agreement from the franchisor for the information to be disclosed as part of the diligence process. This protection is often necessary because the definition of confidential information in the franchise agreement is likely to cover only the information disclosed by the franchisor as part of the franchise support system. Rarely do obligations run in the opposite direction, requiring the franchisor to treat information disclosed by the franchisee as confidential. If the franchisor operates a dual system with company stores in markets that may be competitive with a franchisee target, the confidentiality agreement should be expanded to include non-use provisions that protect the franchisee from disclosure of its competitively sensitive information to persons unrelated to the transaction.4

A Multi-Market Purchase or a Financial Seller Purchase may be initiated as a highly structured private placement process, where an investment banker is hired to package an offering memorandum containing summary information about the target franchisee that is then circulated to prospective buyers. The franchisee may be obligated to provide a copy of the offering materials to the franchisor for its review and approval in advance of circulation. That approval right may give the franchisor an advantage to negotiate for the purchase either as a legal matter if there is a retained right of first offer or a right of first refusal, or as a practical matter, if the franchisor has knowledge of the offering before the other prospective buyers can see the offering materials.

The franchisor's familiarity with the target franchisee's business enhances the likelihood of an efficient early diligence period and a highly educated, focused information request. Presumably, the franchisor and its agents know the target business generally, and need only research the particular aspects of the franchisee's management of the business that were not already known to the franchisor.

The early diligence must provide the buyer with sufficient information that allows it to develop approaches to these key issues: 1) the buyer's ownership structure and financing sources for the purchase price; 2) the tax attributes of the transfer to the seller and the buyer; 3) the financial accounting treatment of the purchase price for the buyer; and 4) the risk management and allocation between buyer and seller for known and unknown risks associated with the business. Counsel will need to consider and document the interaction with the client to assure that all of these essential elements are considered by the client and its legal, accounting and tax advisors before the transaction proceeds past the preliminary stage. For presentation purposes, we present the grid below to assess these elements in the context of our three transaction categories, and offer our observation of the most likely path the transaction structure will follow. We assume that the buyer is the franchisor or an affiliate, there is no seller financing, and the franchisor and its affiliates have no pre-existing equity interest in the seller or its assets other than the franchise agreement or the development agreement. As tax rules vary depending on the seller's structure - C-corporation, S-Corporation or Partnership/LLC, the discussion below is divided into non-tax and tax issues.

4 See, e.g., Camp Creek Hospitality Inns v. Sheraton Franchise Corp., 130 F.3d 1009 (11th Cir. 1997); Bus. Fran. Guide (CCH) ¶11,306 (11th Cir. 1997)
<table>
<thead>
<tr>
<th>Issue</th>
<th>Owner/Operator</th>
<th>Multi-Market</th>
<th>Financial Seller</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Deal Type</strong></td>
<td>Asset Purchase</td>
<td>Assets if modest number of outlets; Equity Purchase if substantial outlets involved</td>
<td>Equity Purchase</td>
</tr>
<tr>
<td><strong>Buyer Ownership Vehicle</strong></td>
<td>Operating Affiliate or Special Purpose Entity for transaction</td>
<td>Operating Affiliate or Special Purpose Entity if assets; Parent entity or intermediate holding company if equity purchased</td>
<td>Parent entity or Operating Affiliate</td>
</tr>
<tr>
<td><strong>Buyer Debt Financing Options</strong></td>
<td>Simultaneous single outlet financing with parent guaranty; group financing secured by acquiring entity equity pledge</td>
<td>Group financing secured by acquiring entity equity pledge</td>
<td>Group financing secured by acquiring entity equity pledge</td>
</tr>
<tr>
<td><strong>Financial Accounting for Buyer under GAAP</strong></td>
<td>Acquisition Method under FASB 141R and ASC 805; Goodwill recognized as difference between Purchase Price and fair value of assets acquired minus liabilities assumed</td>
<td>Acquisition Method under FASB 141R and ASC 805; Goodwill recognized as difference between Purchase Price and fair value of assets acquired minus liabilities assumed</td>
<td>Acquisition Method under FASB 141R and ASC 805; Goodwill recognized as difference between Purchase Price and fair value of assets acquired minus liabilities assumed</td>
</tr>
<tr>
<td><strong>Risk Management</strong></td>
<td>Seller continuity of risk of unassigned liabilities not assumed by Buyer</td>
<td>Seller continuity of risk of unassigned liabilities not assumed by Buyer for asset transactions; Seller indemnity for undisclosed liabilities in equity transactions</td>
<td>Buyer likely to assume risk of undisclosed liabilities in equity transactions with protection only for errors and omissions on balance sheet</td>
</tr>
<tr>
<td><strong>Purchase Price Holdback</strong></td>
<td>Yes, usually 10-25% for one year to 18 months</td>
<td>Yes, usually 5-15% for one year on asset purchase; Equity usually lower amount and shorter period</td>
<td>No if seller can answer for claim; Yes, for balance of tax year if seller is liquidating or cannot answer</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>Diligence Issues</th>
<th>Purchase Category</th>
<th>Owner/Operator</th>
<th>Multi-Market</th>
<th>Financial Seller</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Deferred</td>
<td>Deferred</td>
<td>Owner/Operator Multi-Market</td>
<td>Financial Seller</td>
<td></td>
</tr>
<tr>
<td>Maintenance</td>
<td>Deferred</td>
<td>Owner/Operator Multi-Market</td>
<td>Financial Seller</td>
<td></td>
</tr>
<tr>
<td>2. Human Resources Compliance</td>
<td>Deferred</td>
<td>Owner/Operator Multi-Market</td>
<td>Financial Seller</td>
<td></td>
</tr>
<tr>
<td>3. Tax Compliance</td>
<td>Deferred</td>
<td>Owner/Operator Multi-Market</td>
<td>Financial Seller</td>
<td></td>
</tr>
<tr>
<td>4. Revenue</td>
<td>Deferred</td>
<td>Owner/Operator Multi-Market</td>
<td>Financial Seller</td>
<td></td>
</tr>
<tr>
<td>Reporting and Cash Flow Accuracy</td>
<td>Deferred</td>
<td>Owner/Operator Multi-Market</td>
<td>Financial Seller</td>
<td></td>
</tr>
<tr>
<td>5. Supply Chain Compliance</td>
<td>Deferred</td>
<td>Owner/Operator Multi-Market</td>
<td>Financial Seller</td>
<td></td>
</tr>
</tbody>
</table>

Tax issues are more readily understood by the entity type of each party. Franchisee accountants often prefer using corporations taxed as S-Corporations, while public entities and those whose owners prefer to avoid the application of the franchisee's tax attributes prefer C-Corporations. Limited liability companies are usually taxed as partnerships or S-Corporations. Most transactions in this arena will be taxable events. If the franchisor is using its publicly traded stock as currency, the transaction may qualify for tax free treatment as long as cash or other property is received by the seller below a threshold for receiving "boot."
<table>
<thead>
<tr>
<th>Tax Partnership</th>
<th>S Corporation</th>
<th>C Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Seller</td>
<td>Buyer</td>
<td>Seller</td>
</tr>
<tr>
<td><strong>Taxable Asset Sale</strong></td>
<td><strong>Capital gain or loss passed through to the owners except for ordinary treatment of depreciation recapture and certain other ordinary income items; owner's net operating losses may be used to offset taxable gain</strong></td>
<td><strong>Buyer's purchase price basis is allocated among the assets including goodwill if purchase price exceeds assets' fair market value</strong></td>
</tr>
</tbody>
</table>

Franchisors monitor the system-related performance of franchisees, so the issues for diligence focus on the aspects of the business that franchisors do not monitor. Before any indication of interest is communicated, or at the first indication that the franchisee or outlets are for sale, the franchisor will marshal its latest reports and audits on the franchisee and outlets, decide what information is current, reliable and sufficient, and what information is lacking. What
issues, matters and facts that the franchisor needs to know or understand about the outlets or franchisee for sale that the existing franchise system reports do not provide? Do the current reports suggest avenues of efficient inquiry? Where does the franchisee or the outlets rank on the system’s key performance metrics? Are the outlets more important to the franchise system than the financials alone? Are these billboard outlets that provide consumer marketing awareness or franchise recruitment benefits, or provide an anchor group for an important market that affects the regional or local cooperative? Do these outlets have an impact on system performance reports included in Item 19 of the franchisor’s franchise disclosure document (“FDD”)? Do these outlets represent a set or subset of outlets that the franchisor wants to retain, remodel or scrape and replace? Depending on the level of interaction with franchisee management during the life of the franchise, and the information about the franchisee available from other sources, these questions fill in the key diligence gaps:

1. What is the status of all primary vendor relationships, particularly with landlords, lenders and key system suppliers?

2. Does the franchisee have a robust compliance program for employee wages and hours, which is an announced element of Federal and state regulatory scrutiny, as a result of well-publicized failures of large franchisees to meet their regulatory burdens?

3. Does the franchisee operate an accounting function with reliable internal controls, particularly on cash management and expenses, for the affiliate or outlets being sold?

4. How much has mandated or advisable maintenance, upgrades, renovation or replacement been deferred, delayed or underperformed? Has customer service and satisfaction been adversely affected? How much effort and resources will be needed to restore the customer experience to expected levels?

5. Does the franchisee operate with supply chain relationships that are outside the norm for the system? What is the effect on the business and the financial results?

6. What other operating variables are outside the brand’s system norms and experience, and are these outlets significant in the brand’s marketing efforts?

Early stage diligence directed to answer these questions can produce sufficient information for the franchisor to model performance for the outlets to be sold and price the transaction in a letter of intent.

For franchisors, another planning component is whether to “warehouse” the outlets or the franchisee entity for future sale after a relatively short holding or diligence period, or whether the outlets and franchisee entity acquired will be fully integrated into the enterprise so that resale, or “refranchising,” will be more significant from an operational, legal and financial accounting perspective. Maintaining a separate entity will isolate risk, particularly if diligence is not complete or there are unknowns that linger, and may ease transition of managers who are accustomed to a profits interest or bonus plan based on performance of the outlets that may be difficult to duplicate in a fully integrated business. For a block of outlets that may be repackaged and resold, or if inchoate development rights and obligations can be profitably resold, an entity transaction followed by maintaining entity separation may produce more value for the franchisor long term. This approach may also support financial reporting and comparison for potential buyers, and works more efficiently when a Financial Seller Purchase is an interim step or
system continuity play between private equity ownership of the outlets. If the outlets suffered at the hands of the seller's management or cash needs, a performance bounce back after the application of a more benign and beneficial approach to ownership may produce substantial value appreciation for the franchisor in a resale scenario. This could require significant investment of the franchisor's own resources, which must be considered when assessing this option.

III. Letters of Intent

When the buyer has sufficient information to formulate an offer in a negotiated transaction or an open bid transaction where the potential buyers are free to submit their own offers, the transaction then proceeds with a letter of intent or term sheet. The letter of intent should be crystal clear on the question of whether it is binding on both of the parties, the seller alone, or binding only in part, such as a no-shop or exclusivity provision that provides the buyer with a defined period of time in which to complete its diligence and proceed to a definitive agreement for the transaction. In a structured sale, a mandated form containing substantially all of the terms of the letter of intent except for pricing information may be included in the offering memorandum.

A franchisor buying a franchisee is a uniquely sensitive transaction, as the parties have a pre-existing and continuing commercial relationship as franchisee and franchisor. Unlike a traditional ad hoc transaction where the parties are less likely to have had any prior commercial dealings, the franchisor and franchisee have a history dating back to the delivery of the franchisor's Franchise Disclosure Document. The commercial relations of the parties are already complex and circumscribed by the franchise agreement, a development agreement, any number of ancillary agreements, routine information and payment exchanges, during the period of the franchisee's operation. For that reason, the letter of intent must be clear and well understood because the parties will not simply walk away from each other if the transaction does not proceed. Unfortunately, the letter of intent, which franchise principals may pursue and sign without counsel's assistance, may have unintended consequences.

There are three possible outcomes of a letter of intent. First, a letter of intent may be completely unenforceable. For example, in *BPI Energy Holdings, Inc. v. IEC (Montgomery), LLC*, the court held a letter of intent was unenforceable, because the language of the agreement acknowledged that it did not constitute a "binding obligation." On the other hand, a letter of intent may be completely binding on the parties. In this situation, a party must perform the "ultimate objective" of the agreement, unless he or she can present an excuse of performance or another defense. Further, in jurisdictions following the modern trend set by the New York case *Teachers Ins.and Annuity Ass'n.v.Tribune Co*., a letter of intent may create a binding obligation on the parties to negotiate in good faith towards the ultimate objective of the contract. In this situation, the parties are not actually bound to perform the substance of the contract.

664 F.3d 131, 135-36 (7th Cir. 2011).

Brown v. Cara, 420 F.3d 148, 154 (2d Cir. 2005).


670 F. Supp. 491 (S.D. N.Y. 1987)

See id.
As a result, the parties can still exit the deal if good faith negotiations do not meet their expectations. We next examine a fully enforceable letter of intent and an agreement to negotiate in good faith.

A. Fully Enforceable

Courts consider several factors when determining if a letter of intent is fully enforceable. Courts consider the "intent of the parties to be bound," which is gleaned through the actual language of the agreement and the context of negotiations. For example, if a party expressly reserves the right not to be bound, then a court is very unlikely to hold that the party is bound to the substantive terms of a letter of intent. Next, courts consider the extent to which the parties have agreed to all the material terms of the contract. Further, courts consider the parties' performance and the requirement of a formal writing depending upon the complexity of the deal. However, these last factors are rarely conclusive of a party's intent to be bound by a letter of intent.

In re Marine Risks, Inc. provides a good example of how these factors are applied by courts in the context of acquiring a business. In that case, the debtor was in the business of brokering insurance, and planned to sell its brokerage contracts to a competitor. The debtor signed a letter of intent with the competitor, which outlined the terms of the proposed transaction. During the due diligence period, a key executive of the debtor was indicted for fraud and grand larceny, which caused the competitor to exit the deal and forced the debtor into bankruptcy. In the bankruptcy case, the trustee of the debtor's estate asserted that the key executive tortiously interfered with the contract to sell the debtor's brokerage contracts to its competitor. Therefore, the main issue was whether the letter of intent constituted a fully enforceable agreement under New York law.

The court determined that the letter of intent was unenforceable. First, the court examined the language of the agreement, which clearly indicated the parties did not intend to be

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12 See Falls Garden Condominium Ass'n, Inc. v. Falls Homeowners Ass'n, Inc., 107 A.3d 1183, 1192-93 (Md. 2015).
14 See id.
16 Id. at 189-91.
17 Id. at 191-92.
18 Id.
19 Id. at 187.
20 Id. at 208.
21 Id.
Specifically, the agreement gave the purchaser the "sole right" to determine if there was merit in purchasing the debtor's clientele after conducting due diligence. Therefore, the purchaser did not make a firm commitment to be bound based upon the language of the agreement. Second, the agreement contained several open terms. The agreement did not name specific clients that would be transferred or which employees would remain members of the surviving brokerage. In fact, the only definite term in the agreement was the consideration to be paid to the debtor for selling its assets.

The remaining factors - performance, context, and requirement of a writing- likewise did not favor the formation of a fully enforceable agreement. Neither the buyer nor the seller took steps towards performance or indicated in negotiations that they agreed upon the specific details or structure of the transaction. Instead, the buyer merely conducted initial due diligence and decided to terminate the transaction. Further, the "requirement of a writing" was not sufficient to overcome the parties express intention not to be bound based upon the language of the agreement and the context of negotiations. As a result, the court determined that the letter of intent was not an enforceable contract.

By contrast, in Falls Garden Condominium Ass'n v. Falls Homeowners Ass'n, Inc., a Maryland court determined that a letter of intent, which set forth the terms of a lease of several parking spaces, was a fully enforceable agreement. In that case, the court relied primarily on the fact that the agreement included all the material terms of a typical lease. The agreement included the length of the lease, the number of units to be leased, the location of those units, and the price to be paid by the lessee. The agreement also described the parties' responsibilities throughout the term of the lease. The agreement did expressly contemplate the execution of a future agreement; however, the Maryland court said "the mere fact a letter of intent explicitly contemplates a future contract" does not make it unenforceable if the parties "express definite agreement on all necessary terms." Therefore, the Maryland court held the

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22 Id. at 209.
23 Id.
24 Id.
25 Id.
26 Id. at 209-10.
27 Id.
28 See Id.
29 107 A.3d 1183 (Md. 2015).
30 Id. at 1188.
31 Id. at 1192.
32 Id.
33 Id. at 1188-90.
agreement was fully enforceable because the parties had agreed to all the material terms of a lease.

B. Preliminary Agreement to Negotiate in Good Faith

Most jurisdictions now recognize a "preliminary agreement to negotiate in good faith." Courts consider five factors to determine whether an agreement creates an obligation to negotiate in good faith. Specifically, courts consider: (1) the intention of the parties, based on the language of the agreement; (2) the context of negotiations; (3) the existence of open terms; (4) partial performance; and (5) the customary form of the transaction. The language of the agreement is still the most important factor for courts. However, the existence of open terms, by definition, is not fatal to the formation of an obligation to negotiate in good faith. A preliminary agreement to negotiate in good faith does not obligate the parties to finalize the transaction or completely perform the ultimate objective of the contract. Therefore, a contracting party does not have a claim for breach of preliminary agreement as long as the other party negotiates in good faith.

In *Trianco*, the court considered whether an agreement to formulate a bid for a government contract constituted a preliminary agreement to negotiate in good faith towards a subcontract. In that case, Trianco helped International Business Machines ("IBM") formulate its bid for a government contract to provide computerized checkstands at military commissaries. If the bid was accepted, IBM agreed to negotiate a subcontract with Trianco to install the checkstands. IBM was awarded the contract, but IBM bid out the subcontract and Trianco's bid was not selected.

The court determined that the agreement created an obligation to negotiate in good faith for numerous reasons. First, the language of the agreement expressly stated "the parties will negotiate in good faith mutually acceptable terms and conditions of [a] subcontract." Second, the context of negotiations indicated "the parties wanted a general framework within which they could proceed while preserving flexibility in the fact of uncertainty." Put differently, the parties

34 *Trianco*, 583 F. Supp. 2d at 656-57.
35 Id.
37 *Trianco*, 583 F. Supp. 2d at 661.
38 Id. at 659.
39 Id. at 652.
40 Id. at 653.
41 Id.
42 Id. at 659.
43 Id. at 652, 659.
44 Id. at 660 (quoting *Brown v. Cara*, 420 F.3d 148, 158 (2d Cir. 2005)).
needed to enter into a preliminary agreement to pool resources for the bidding process, but did not desire the agreement to be fully binding because neither party knew if IBM would receive the contract. Trianco also partially performed under the agreement by providing extensive technical assistance in the preparation of IBM’s bid for the contract. Lastly, parties customarily executed “teaming agreements” at the bid stage of government contracts in order to pool resources, and, then, negotiated a full subcontract upon winning the bid. Therefore, all five factors favored the formation of an obligation to negotiate in good faith.

Further, in Main Street Baseball, LLC v. Binghamton Mets Baseball Club, Inc., the court had to consider whether a letter of intent was fully enforceable or just a preliminary agreement to negotiate in good faith. The court concluded that serious factual questions existed as to whether the agreement was fully enforceable based upon the language of the agreement. The court noted that the agreement did not specifically state it was non-binding, and the agreement specified, in considerable detail, the parties’ respective obligations. Nevertheless, the opening sentence of the agreement indicated that the document only “outlined” the terms of the parties’ intent to “pursue” a “proposed acquisition.” Such non-committal language created a factual question as to whether the agreement was just a preliminary agreement to negotiate in good faith or a fully binding agreement.

Some jurisdictions, such as Kentucky, take an "all or nothing" approach to letters of intent. In these jurisdictions, parties cannot form a preliminary agreement to negotiate in good faith because all preliminary agreements are unenforceable. For example, a Kentucky court held a letter of intent was an unenforceable "agreement to agree" when the agreement was missing definitive price terms. In that case, the parties’ agreement contained a formula to determine price, but the agreement framed the pricing terms in permissive language and in the future tense. Therefore, under an "all or nothing" approach, contracting parties have no chance of becoming bound to a general framework of negotiation after executing a letter of intent.

45 See id.
46 Id. at 662-63.
48 Id. at 257.
49 Id.
50 Id.
51 See id.
52 Giverny Gardens, LP v. Columbia Housing Partners LP, 147 Fed. Appx. 443, 448-49 (6th Cir. 2005) (indicating that New York’s approach is the modern trend but that Kentucky follows a traditional "all or nothing" approach).
54 Id. The agreement continuously used the word “shall.” ld.
IV. Deal Points

The Letter of Intent is the focal point of negotiation on key commercial terms and legal points of contention that will be critical to settle before the parties expend energy on more diligence and drafting an agreement. We discuss here certain deal points that are uniquely affected by a franchisor acquisition of franchised outlets.

The American Bar Association Business Law Section, Mergers & Acquisitions Committee, M&A Market Trends Subcommittee publishes a "Private Target M&A Deal Points Study" every 2-3 years with survey data on critical deal points, organized by the size of the transactions reported. The latest studied 117 transactions in 2014, with asset deals representing 17% of the sample. We will use the Target Study to provide context on a number of deal points relevant to our discussions.

A. Exclusivity

A key element of the early stage discussions is whether the franchisor will be granted exclusive negotiating rights for the transaction. At the point where the benefits of additional competition for the transaction in terms of price and certainty are outweighed by the need for intensive resource application to complete the diligence and finalize terms, exclusivity is appropriate. The grant is usually limited by the seller's assessment of the time necessary for an energetic completion of diligence and the documentation period. The loss of exclusivity may also be triggered by external events that represent macroeconomic or substantial market changes, a material adverse change in the buyer's financial condition or business, commencement of material litigation or arbitration, a regulatory event or an announcement of another transaction by the buyer which may indicate a resource availability challenge.

A franchisor acquisition of a franchisee's business or assets follows the activation of the transfer restrictions in the franchise agreement or other organic agreement between the franchisee and the franchisor. As a practical matter, any other buyer will be subject to the review and approval process reserved in the franchise agreement or a relationship agreement, in the case of Financial Seller Purchase. For smaller franchisors faced with the prospect of arranging financing of the transaction, the exclusivity period may be necessary to create a financial plan to fund an unanticipated expenditure. Exclusivity forces the parties to move quickly, which is beneficial to a going concern transaction where business continuity is important.

B. Representations & Warranties

The letter of intent will include a blanket statement about representations and warranties in the purchase and sale agreement, stating that the definitive agreement will include customary representations and warranties, covenants and conditions, because more detail would obviate the need for an abbreviated preliminary document. Indeed, both the ABA Model Asset Purchase Agreement and the ABA Model Stock Purchase Agreement include numerous representations and warranties that firms have modified to fit particular circumstances. [A list of these representations and warranties for the seller and the buyer appears in the Appendix.] But what are the benefits of representations and warranties in a transaction where the buyer is significantly familiar with the seller's business?

1. Misrepresentation & Fraud

A representation is "a presentation of fact - either by words or conduct - made to induce someone to act...."\textsuperscript{56} A false or misleading presentation of fact may give rise to a claim for common law or statutory fraud, which allows parties to recover damages in excess of their expected benefit from the bargain. Therefore, representations in a purchase document must be carefully drafted to prevent potential tort liability.

To prove a cause of action for fraud, a plaintiff must generally plead the following basic elements: (1) the defendant made a statement of material fact; (2) the defendant intended to defraud the plaintiff by making the statement; (3) the plaintiff reasonably or justifiably relied upon the statement; and (4) the plaintiff suffered damage as a result of such reliance.\textsuperscript{57} In the context of mergers and acquisitions, the two major issues in fraud cases are whether the plaintiff can prove the defendant made a statement of "then-existing" material fact and whether the plaintiff had prior knowledge about the statement's falsity such that he or she could not have justifiably or reasonably relied on it.\textsuperscript{58}

\textsuperscript{56} BLACK'S LAW DICTIONARY 16c (10ed. 2010).

\textsuperscript{57} See Banque Arabe et Internationale D'Investissement v. Md. Nat'l Bank, 57 F.3d 146, 153 (2d Cir. 1995) (discussing New York law); Prime Leasing, Inc. v. Kendig, 773 N.E.2d 84, 92 (Ill. App. Ct. 2002) (discussing Illinois law). The Restatement (Second) of Torts, Section 551, offers a clear statement of the law that guides the duty of disclosure and the risk of non-disclosure in business transactions:

- (1) One who fails to disclose to another a fact that he knows may justifiably induce the other to act or refrain from acting in a business transaction is subject to the same liability to the other as though he had represented the nonexistence of the matter that he has failed to disclose, if, but only if, he is under a duty to the other to exercise reasonable care to disclose the matter in question.

- (2) One party to a business transaction is under a duty to exercise reasonable care to disclose to the other before the transaction is consummated,
  - (a) matters known to him that the other is entitled to know because of a fiduciary or other similar relation of trust and confidence between them; and
  - (b) matters known to him that he knows to be necessary to prevent his partial or ambiguous statement of the facts from being misleading; and
  - (c) subsequently acquired information that he knows will make untrue or misleading a previous representation that when made was true or believed to be so; and
  - (d) the falsity of a representation not made with the expectation that it would be acted upon, if he subsequently learns that the other is about to act in reliance upon it in a transaction with him; and
  - (e) facts basic to the transaction, if he knows that the other is about to enter into it under a mistake as to them, and that the other, because of the relationship between them, the customs of the trade or other objective circumstances, would reasonably expect a disclosure of those facts.

\textsuperscript{58} See Sofaer Global Hedge Fund v. Brightpoint, Inc., 2011 WL 2413831, at *9 (S.D. Ind. Jun. 10, 2011) (finding a lender could not reasonably rely on a chief executive officer's statement that a deal was "ninety-nine percent done" when the lender knew the deal was incomplete at the time the statement was made).
Steak 'n Shake Enterprises, Inc. v. Globex Company, LLC provides a good example of how "justifiable reliance" is an issue in fraud cases. In that case, the plaintiffs claimed that Steak 'n Shake fraudulently induced them to invest in the Steak 'n Shake franchise system. The plaintiffs alleged that certain sales employees of Steak 'n Shake misrepresented that franchisees' profit margins were actually closer to $500,000 to $600,000, which was higher than the figures listed in Steak n' Shake's disclosure statement. The court determined that it was unreasonable for the plaintiff to rely on the statements of Steak 'n Shake employees because the plaintiffs, who were sophisticated in the restaurant industry, were entering into the transaction after conducting their own investigation of current franchisees' profit margins. Therefore, the plaintiffs could not have relied on the "puffery" or "trade talk" of the franchisor's sales staff, when they had prior knowledge of the falsity of the sales staff's statements based upon their own investigation of the facts.

Further, in BP West Coast Products, LLC v. SKR, Inc., a federal district court considered the plaintiff's ability to prove reliance in the context of a franchisor communicating with an existing franchisee. In that case, BP West Coast franchised convenience stores and gas stations on the West Coast of the United States. At a conference, BP West Coast's sales manager represented to an existing franchisee that she could expect the margins on gasoline sales to be nine cents per gallon and the margins on in-store sales to be around 30 percent. The court concluded that the franchisee was not entitled to rely on the sales manager's representation concerning franchisee's margins. The franchisee had estimated profits at nineteen percent prior to speaking with the sales manager. Further, the franchise agreement expressly disclaimed any representation or warranty concerning "an operator's income or profits." The court also noted that the statements related to "future performance" as opposed to an existing fact. The statements accordingly were not actionable, even if the plaintiff proved reasonable reliance.

59 110 F. Supp. 3d 1057 (D. Colo. 2015).
60 Id. at 1081.
61 Id.
62 Id. at 1082-83.
63 Id.
64 989 F. Supp. 2d. 1109. (W.D. Wash. 2013).
65 Id. at 1113-14.
66 Id. at 1120.
67 Id.
68 Id.
69 Id.
70 Id.
Finally, *Pacific Cycle, Inc. v. Powergroup Int'l, LLC*\(^7\) highlights what types of statements relate to an "existing fact" in fraud claims. In *Pacific Cycle*, Pacific Cycle sold a license to PowerGroup to sell Schwinn motor scooters.\(^2\) PowerGroup contended, among other things, that Pacific Cycle misrepresented that opening a motor scooter business was a "turn-key operation."\(^3\) The court determined that this statement was merely a "vague expression of puffery or opinion," which did not relate to a "fact."\(^4\) Further, the phrase "turn-key operation" related to the possibility of future success without much effort on the part of the licensee.\(^5\) As a result, the phrase did not relate to a "then-existing fact," but instead, discussed the possibility of future success.\(^6\) Therefore, it was not an actionable misrepresentation.

In sum, a misrepresentation can form the basis of a fraud claim if the plaintiff can show the four elements of fraud. In most deals, particularly involving sophisticated parties, the major issue is whether or not the plaintiff could have reasonably relied on the alleged misrepresentation, if he or she had prior knowledge of its falsity. Courts will most likely hold a plaintiff cannot prove reasonable reliance if the plaintiff has conducted its own diligence, which provided the plaintiff with similar or superior knowledge to the defendant. Further, in some contexts, courts face the issue of whether statements are about "then-existing facts" or future performance. If a sales person engages in puffery or trade talk, then the alleged misrepresentation does not concern a "fact." Further, if a seller predicts a buyer will experience financial success in the future, such a prediction is not actionable because it does not relate to a "then-existing fact."

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\(^7\) 969 F. Supp. 2d 1098 (W.D. Wis. 2013).

\(^2\) Id. at 1101

\(^3\) Id. at 1114.

\(^4\) Id.

\(^5\) Id.

\(^6\) Id.
2. Breach of Express Warranty

A warranty is an affirmation of fact intended to induce a person to enter into a contract. To prove a claim for breach of express warranty, a plaintiff generally must show: (1) a material statement amounting to a warranty; (2) the plaintiff "bargained for" the warranty; (3) the fact warranted was false; and (4) the plaintiff suffered damage as a result of the warranty. In contrast to fraud claims, a plaintiff does not have to show "reasonable or justifiable reliance" to establish a prima facie case for a breach of warranty in most jurisdictions, as long as the warranty induced the plaintiff into the bargain. For example, a buyer "bargained for" a warranty, and thus did not have to show reasonable reliance, when it insisted upon inserting the warranty into a draft of the contract prior to closing. The seminal New York case of *CBS Inc. v. Ziff Davis Publishing, Inc.* established this analysis as the majority view of warranty claims. However, a plaintiff may waive his or her claim for breach of warranty if the plaintiff entered into the contract with full knowledge that a warranty was false and did not reserve the right to later assert a claim for breach. Therefore, breach of warranty remains a possibility for plaintiffs, who have prior knowledge of a statement's falsity, so long as they reserve their right to assert the claim at a later date.

In *Project Gamma Acquisitions Corp. v. PPG Industries, Inc.*, a New York trial court discussed at length the difference between the levels of reliance required under a fraud claim versus a breach of warranty claim. The court reasoned that the critical issue in a fraud claim is whether the plaintiff "believed the statement to be false" or knew enough facts to discern that the statement was false. By contrast, in warranty reliance, the key question is not whether the plaintiff "believed in the truth of the warranted information... but whether it was purchasing the defendant's promise as to its truth." In *PPG Indus.*, the court granted the plaintiff's summary judgment motion on breach of warranty, even though the plaintiff knew that lower customer sales or prices could flow from the execution of a merger. The court reasoned that the plaintiff

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81 Id. at 34 Misc. 3d 771 (N.Y. Sup. 2011).


83 Id. at 778.

84 Id.

85 Id. at 778-79.
had "bargained for" a warranty to insure against the risk of lower customer sales or prices. As a result, the plaintiff's "prior knowledge" of the sales should not preclude recovery unless the plaintiff waived his or her right to assert a claim for breach.

Moreover, in *Pentair, Inc. v. Wisconsin Energy Corp.*, a federal district court, applying Wisconsin law, considered the issue of whether a buyer reserved his or her right to assert a warranty claim. The court held that the buyer did reserve his or her right to assert a breach of warranty claim because the agreement contained a "general reservation of right" clause. The seller argued that the buyer should have to specifically reserve the right to assert a breach of warranty claim, as opposed to "any and all claims." The court disagreed, reasoning that "requiring each party to a contract to recite, in writing, every point on which it may have knowledge of a possible breach by another party would vastly increase the cost...of negotiating contracts." *Pegasus Management Company, Inc. v. Lyssa, Inc.* is at the other end of the spectrum in waiver cases. In that case, the court concluded that the buyer did not waive his or her right to assert a breach of warranty claim, because the purchase document specifically stated "every warranty survived closing regardless of the buyer's knowledge."

There are other views on the issue of reliance in breach of warranty cases. For example, the Tenth Circuit, applying Kansas law, held that reliance was an essential element of a claim for breach of an express warranty. Further, a California appellate court determined, with no reference to the *Ziff-Davis* case, that reliance must be proved in the sale of a business, even though the California Uniform Commercial Code expressly disclaimed reliance as a requirement in a warranty claim relating to the sale of goods. However, the Tenth Circuit and California's reasoning on the issue of reliance is likely to remain as the minority approach. The *Land* decision involved a federal court attempting to divine an issue of first impression under state law. Further, the *Kazerouni* decision did not offer detailed reasoning and failed to distinguish the seminal cases on the issue of reliance.

In conclusion, a breach of warranty claim remains a viable alternative for a buyer who cannot show "justifiable reliance" in a fraud claim because he or she had prior knowledge of facts that would allow him or her to discern the truth or falsity of the alleged misrepresentation. Although buyers can waive their right to assert a breach of warranty claim, a buyer can easily

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88 Id.
89 662 F. Supp. 2d 1134 at 1139 (D. Minn. 2009).
90 Id. at 1144-45.
91 Id.
92 Id. at 1144-45.
94 See *Land v. Roper Corp.*, 531 F.2d 445, 447-49 (10th Cir. 1976).
97 See Id.
protect itself by including an express provision stating that "all warranties survive closing regardless of the buyer's prior knowledge."

3. **Sandbagging/Anti-Sandbagging**

A key deal point, in light of the discussion above, is whether the letter of intent or the acquisition agreement includes an anti-sandbagging provision. This creature prohibits claims assertion by the buyer based on the buyer's knowledge as of the closing date about any inaccuracy of any representation or warranty, or any schedule presenting facts that are part of the acquisition agreement. A typical pro-sandbagging indemnity provision reads:

The right to indemnification, reimbursement or other remedy based upon such representations, warranties, covenants and obligations shall not be affected by any investigation (including any environmental investigation or assessment) conducted with respect to, or any Knowledge acquired (or capable of being acquired) at any time, whether before or after the execution and delivery of this Agreement or the Closing Date, with respect to the accuracy or inaccuracy of or compliance with any such representation, warranty, covenant or obligation. The waiver of any condition based upon the accuracy of any representation or warranty, or on the performance of or compliance with any covenant or obligation, will not affect the right to indemnification, reimbursement or other remedy based upon such representations, warranties, covenants and obligations. 98

This language expressly permits "sandbagging," meaning that even if the buyer knows a representation, warranty or related factual information is wrong at the time of the Closing, the seller remains liable for losses caused by the inaccuracy or breach. It is sometimes called, "belt and suspenders," where regardless of the diligence conducted, the seller remains liable for inaccuracies up to the limits of the indemnification.

An anti-sandbagging provision would read as follows:

[Except as set forth in a Certificate to be delivered by Buyer at the Closing,] to the Knowledge of Buyer, Buyer is not aware of any facts or circumstances that would serve as the basis for a claim by Buyer against Seller or any Shareholder based upon a breach of any of the representations and warranties of Seller and Shareholders contained in this Agreement [or breach of any of Seller's or any Shareholders' covenants or agreements to be performed by any of them at or prior to Closing]. Buyer shall be deemed to have waived in full any breach of any of Seller's and Shareholders' representations and warranties [and any such covenants and agreements] of which Buyer has such awareness [to its Knowledge] at the Closing.

The Target Study found that 35% of the transactions included a pro-sandbagging provision, 9% included an anti-sandbagging provision, and 56% of the deals were silent. What does silence mean in this context? It means that common law fraud rights and defenses are preserved, and the parties may assert claims but must prove reliance was justified or not, and whether knowledge of the buyer was or was not an exculpatory factor. In the context of a franchisor acquisition of a franchisee, particularly where the seller is a Financial Seller that relies

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98 ABA Model Asset Purchase Agreement, Section 11, Second Edition.
almost entirely on management for information, the pro-sandbagging provision would seem to be a less supportable position.

C. Indemnification

A critical feature of any acquisition is indemnification for liabilities and contingencies not accepted by the exposed party in the contract. The parties create a risk allocation mechanism in the acquisition agreement that is a function of the actual and deemed knowledge of the parties and the ability to identify and quantify risks in diligence, in particular risks that diligence may or may not identify and quantify accurately. In the Target Study, 90% of all deals held that indemnification was the exclusive remedy of the buyer for breaches of representations and warranties, with carve outs for common law fraud or torts of intentional misrepresentation.

In the context of a franchisor acquisition of the franchisee, should the franchisor's knowledge of the business affect the indemnification amounts or scope? Certainly, the indemnity in favor of another buyer for franchise matters that are not disclosed properly or valued correctly, such as default status, cure requirements or upgrade mandates that must be effected, is largely irrelevant. Conversely, the indemnity for underpayment of royalties, underreporting of revenues or underpayment of taxes based on sales or use accruing before the closing date should be unaffected.

The buyer usually accepts risks that there are small inaccuracies in asset schedules and liability amounts in what is known as a "deductible." Each claim may also be subject to an eligible claim minimum, so that small claims will not consume valuable resources that may exceed the value of the claim, although once the ineligible small claims reach an aggregate, the excess or the total value may be added to the deductible. When liabilities exceed the amount of the deductible, the seller is liable for claims that exceed that amount, up to the indemnification limit. Buyers will request a tipping basket, which means that when the indemnity/reimbursement hits a set amount, called the "threshold," the basket tips, and the seller is liable from the first dollar of loss, until the indemnification limit is reached. Some risks, like fraud, intentional breaches, title to the conveyed assets or unpaid liens for unpaid taxes that attach to conveyed assets, have no limit so the buyer is protected if it is deprived of the benefit of the bargain.

The Target Study categorized its deals into "Deductible" deals, where the indemnity was limited to amounts in excess of the Deductible, a "First Dollar" or "tipping basket" approach where once the threshold was reached the seller was responsible for all losses, and a "Combination" approach, where once the threshold was reached, the basket tipped but only from a lower amount than the threshold, and not from the first dollar. The Target Study found that 65% of the deals used a Deductible approach, 26% used a First Dollar approach, and 7% used a Combination approach.

How big were the baskets, or in other words, how much risk were the buyers willing to take on? The Target Study found that 9% of the deals had baskets of between 1% and 2% of transaction value, 38% of the deals had baskets of 0.5 to 1% of transaction value, and 52% had baskets of 0.5% of transaction value or less. So buyers had little to no tolerance for inaccuracy.

How much would the seller be liable for if the indemnification provision were called upon by the buyer? The Target Study found that only 3% of all transactions put the entire purchase price at risk. Sellers were at risk for less than 10% of the purchase price in 50% of the transactions, for exactly 10% of the purchase price in 9% of the deals, for more than 10% up to 15% in 22% of the deals, for more than 15% up to 25% in 11% of the deals, and for more than
25% up to 50% of the purchase price in 11% of the deals. While those limits may seem to be low, placing a premium on diligence competence, the typical carve outs (present in at least 25% of the deals), include losses and related expenses arising from broker's and finder's fees, capitalization, due authority, due organization, equity ownership, taxes, fraud, intentional breach of representations, and breach of covenants. At a minimum, 74% of the transactions reserved the right to equitable remedies if the indemnification was the exclusive remedy of the buyer.

D. Holdbacks & Offsets

One means of funding the indemnification is an escrow or holdback of the purchase price. If the proceeds from the sale are being distributed after the closing, this remedy might be the only practical way to collect amounts owed under the indemnification by a seller, except for insurance proceeds. The buyer wants to hold back and not pay a portion of the proceeds so it has less to fund at closing, and may even cash flow finance the hold back amount. The seller wants the amount escrowed with a third party fiduciary, with strict and clear procedures for repayment to the buyer so the seller gets the money unless the buyer asserts a timely claim on a good faith basis that prevents disbursement. The parties normally provide for an expedited alternative dispute resolution procedure with minimal appeal rights of the decision maker's report and disposition.

The Target Study found that 26% of the transactions with holdbacks made the amount of the holdback the exclusive remedy for the indemnification, and that 47% of the deals made the holdback not exclusive. Only 21% of the deals had no holdback.

How much of the purchase price is held back or escrowed? The most common amount (23%) was between 10% and 15% of the transaction value, followed by between 7% to 10% of the price (19%), and between 3% and 5% of the price (15%). The mean was 9.14%, the median 7.50% and the maximum was 53.7% of the purchase price.

An alternative to the holdback if the transaction has seller financing is an offset right against payments of principal and interest due under the seller financing note from the buyer. The claim can be offset against the next payments of interest on and principal of the seller financing note, or applied to principal in inverse order of maturity to advance the maturity date, while maintaining the same periodic payment. Some notes even have a reset feature that applies the claim value against the principal amount of the note at the date of issuance, recalculates interest on the reduced principal amount, and applies any excess as a further reduction of principal as of the calculation date.

E. Material Adverse Changes Before Closing

Buyers utilize material adverse event or material adverse change ("MAC") clauses to allocate to the seller the occurrence of a pre-closing event that adversely effects the seller's business.\(^{99}\) Generally, MAC clauses appear in one of two forms: (1) a closing condition that entitles the buyer not to close if the business suffers a MAC between a specified date and the closing date; or (2) a seller representation that the business has not suffered a MAC between a specified date and the closing, plus a closing condition that entitles the buyer to exit the deal if

such a representation is not true at closing. MAC provisions generally include a definition of what constitutes a material adverse change, and that definition is subject to certain "carve-out" events for which the buyer is willing to assume the risk such as general macroeconomic or industry-wide changes.

The party seeking to excuse his or her performance - generally the buyer - has the burden of proving a material adverse change has occurred. Courts consider three general issues when determining if a MAC has occurred: (1) whether the party seeking excuse of performance knew about the material adverse effect; (2) whether the alleged effect substantially threatened the overall earnings potential of the target; and (3) whether the material adverse effect will have a significant effect over time.

Recent cases have confirmed that a buyer faces a "heavy burden" when attempting to excuse performance under a MAC clause. In *Hexion v. Huntsman*, for example, a merger agreement contained a MAC clause, which was subject to certain "carve outs," including adverse changes in the seller's industry. The buyer argued that the seller suffered a MAC in its financial condition because the seller's earnings declined in comparison to other company's earnings in the same industry. The court rejected the buyer's argument and concluded that there was no MAC. The court said the plain meaning of the "carve outs" was to prevent certain occurrences, which would otherwise be a MAC, from being classified as a MAC. Therefore, the court first had to determine whether the buyer suffered a MAC before comparing it to other companies in the industry. The court then concluded that a MAC had not occurred because (a) the seller's EBITDA only dropped by seven to eleven percent over the subject time period; (b) the seller's net debt only increased by five percent; and (c) the seller's problem divisions only constituted twenty-five percent of the company and were likely to experience growth soon.

Moreover, in *Genesco, Inc. v. Finish Line, Inc.* , Finish Line argued that it was excused from closing its acquisition of Genesco because Genesco had suffered a MAC, which breached

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100 *Id.*

101 *Id.*


104 *Hexion*, 965 A.2d at 738-39.

105 *Id. at 737.*

106 *Id.*

107 *Id. (emphasis original).*

108 *Id. at 738.*

109 The court rejected using earnings per share as a benchmark in a cash acquisition because earnings per share is sensitive to the seller's capital structure, which is subject to change after the transaction is complete. *Id. at 740.*

110 *Id. at 742-45.*

111 No. 07-2137-II(III) (Tenn. Ch. Dec. 27, 2007).
Genesco's warranties in the purchase document.\textsuperscript{112} The court found that Genesco's financial performance had declined, but the decline was due to general economic conditions and therefore subject to the merger agreement's defined "carve outs."\textsuperscript{113} The court considered the impact of the Genesco's declining financial condition on the buyer's long-term strategy.\textsuperscript{114} In particular, the court believed Genesco's decline in earnings affected the ability of the surviving entity to repay its financing and have excess cash to grow the company, which was the primary reason Finish Line consummated the transaction.\textsuperscript{115} Nevertheless, since the court found that general economic conditions caused Genesco's earnings to decline, it did not matter how "material" the decline was to the deal because the parties had expressly agreed to carve out materially adverse effects caused by economic downturns. Therefore, the court essentially concluded that Finish Line assumed the risk of an earnings decline caused by an economic downturn by accepting the "carve outs" in the merger agreement.\textsuperscript{116}

In sum, buyers can use MAC clauses to shift the risk of adverse, pre-closing events onto the seller. However, a buyer bears the burden of proving that a MAC occurred if he or she wants to excuse performance. Courts will not accept short-term losses as "material" changes to the seller. Instead, the buyer has to show that the alleged adverse effect substantially threatened the earnings potential of the target over a significant period of time. In practice, buyers rarely meet this burden, as recent case law has borne out. In fact, in Hexion, the Delaware Chancery noted that a Delaware court had never excused a buyer's performance under a MAC clause.\textsuperscript{117}

Examining our focal point and how a MAC would be relevant, we conclude that the franchisor is already aware of, perhaps more so than the seller, what risks are inherent to the franchised business, and what should be isolated to the target business. Would the commencement of a case or investigation by the Department of Labor or the National Labor Relations Board, or a state attorney general, alleging unfair labor practices or violations of federal or state labor and employment law be a MAC? A vivid example is the suit filed in May 2016 by the New York State Attorney General against Domino's Pizza franchisees and the franchisor accusing the parties of wage theft, and alleging the franchisor is a joint employer of the franchisee employees.\textsuperscript{118} Perhaps a more realistic example would involve some manner of lease issues with a critical landlord that had a profound impact on the target's finances. What would not be a MAC cause, or what would likely be a carve out, would be a change in the system standards promulgated by the franchisor. Such an event fits the classic definition of

\textsuperscript{112} Kotran et al., supra note 99.

\textsuperscript{113} Id.

\textsuperscript{114} Id.

\textsuperscript{115} Id.

\textsuperscript{116} Id.

\textsuperscript{117} Id.

MAC, but when the franchisor is in the position to effect such an event, it seems inappropriate to allow that self-determination to provide a means of exiting the transaction. In a decentralized organization where the decision of a regional manager to purchase outlets may be under the radar of the senior management of the franchisor, such a possibility is less remote or self-serving, but still seems inappropriate.

F. Representation and Warranty Insurance

1. Background

Representation and warranty insurance ("R & W insurance") provides coverage for indemnification claims a buyer may have for losses resulting from breaches of a seller’s representations and warranties in a purchase agreement.¹¹⁹ R & W insurance can help accelerate the negotiation and closing process by resolving the competing interests of a buyer and seller in a transaction. That being said, R & W insurance is best suited for private deals with transaction values between $20 million and $1 billion.¹²⁰ The premium costs and professional expenses associated with R & W insurance may be excessive for deals valued less than $20 million. Further, insurance companies typically view the coverage for deals valued over $1 billion as too risky.¹²¹ R & W insurance is available in both stock or asset purchase deals and in mergers.¹²²

2. The Advantages of R & W Insurance

R & W insurance benefits the seller by reducing the risk of liability for breaches of representations or warranties by lowering the cap on the seller’s indemnity obligation.¹²³ Further, R & W insurance may reduce the amount of money placed in escrow or other holdbacks, which permits the distribution of more of the sale proceeds at closing to seller.¹²⁴ The data collected through a West Practical Law survey actually bears the latter point out. In the 39 deals with R & W insurance and an indemnification escrow or holdback, the average amount placed in escrow, as a percentage of the total deal value, was 2.93%. However, in the 27 deals with no R & W insurance, but containing some form of indemnification holdback, the average amount of escrow rose to 7.93% of the deal value.¹²⁵ Therefore, buyers reduced the amount of money placed in escrow by 5% when they knew that they could recover on insurance.


¹²⁰ Id.

¹²¹ Id. A recent Practical Law survey, which reviewed publicly available acquisition agreements for 52 deals, found that 61% of deals in the sample that involved R & W insurance were valued between $100 and $500 million. What’s Market Analytics: Representation and Warranty Insurance, WEST PRACTICAL LAW, (Sept. 24, 2015).


¹²³ Whitney et al., supra note 119.

¹²⁴ Id.

¹²⁵ What’s Market Analytics, supra note 121.
R & W insurance also offers several advantages to the buyer, and "buyer-side" policies tend to be more common. First, R & W insurance may allow a buyer to negotiate for the extension of the survival of certain representations and warranties, which allows the buyer more time to detect losses. Further, in the auction context, R & W insurance may distinguish a buyer's bid because it will supplement or substantially replace the seller's indemnification package. R & W insurance also gives the buyer collection security if the buyer is dealing with a financially distressed seller, a large number of sellers, or a seller located in a jurisdiction in which enforcing the indemnification obligation will be difficult or costly.

3. Types of Policies

R & W insurance may be bound with either the buyer or seller as the insured under the policy; however, as stated above, buyer-side policies tend to be more common. Both buyer-side and seller-side policies are generally written as claims-made policies. As a result, the insured must submit any claim for breach of a representation and warranty during the term of policy coverage to preserve the validity of the claim.

Buyer- and seller-side policies share many common terms, but they differ in four important respects. First, the policies differ as to the claim handling process. Under a buyer-side policy, the buyer must file a proof of loss claim directly with the insurer. Under a seller-side policy, by contrast, the buyer must file a proof of loss claim with the seller and the seller would file a claim with the insurer only if the seller believes an insurable loss has occurred. Second, seller-side policies do not cover allegations of seller fraud, while buyer-side policies do. Third, buyer-side policies typically cover a broad range of conduct and have longer policy periods than seller-side policies, which explains why a majority of the policies issued by underwriters are buyer-side. Fourth, the insurer pays differently under buyer-side and seller-side policies. Under a buyer-side policy, the insurer pays the buyer first and then is subrogated to the buyer's right of recovery against the seller, unless the insurer waives its subrogation right for some reason. On the other hand, the insurer usually allows the seller to

126 Whitney et al., supra note 119.
127 Id.
128 Id.
129 Id.
130 Id.
131 Id.
132 Id.
133 Id.
defend claims brought by the buyer and pays the seller’s defense costs and for any losses asserted by the buyer.135

4. Key Policy Terms

Generally, buyers prefer that R & W insurance cover all of the seller’s representations and warranties in an acquisition agreement with only a few negotiated exclusions. However, sellers prefer to structure coverage to apply only to specific representations and warranties, such as financial representations or disclosure representations.

The coverage limit differs based upon the identity of the insured. For seller-side policies, the coverage limit usually equals the indemnification cap, which frequently range between 5% and 15% of the purchase price.136 On the other hand, buyer-side policies can be greater than the indemnification cap and often range between 10% and 30% of the purchase price.137

The policy period of an R & W policy is the period of time when the policy is in effect.138 The policy period normally begins at the closing of the transaction, but may differ depending on the identity of the insured. For seller-side policies, the term is usually the same as the survival period for the seller’s representations and warranties in the purchase agreement.139 For buyer-side policies, the term is a more negotiated provision because the buyer often desires to extend the period beyond the survival date of the representations and warranties in the acquisition agreement. The industry standard for the maximum period is six years.140

The defined terms of an R & W insurance policy are negotiable and should be structured to reflect the objectives of the parties and to conform with the terms of the purchase agreement. The most important defined terms are "breach," "loss," and "insured."141

"Breach" is generally defined as "any breach of, or inaccuracy in, the representations and warranties set out in the acquisition agreement."142 The seller might push for the inclusion of the word "actual" to modify the word "breach," but such a change most often will be resisted by the buyer, since it precludes claims for "alleged breaches."


136 Whitney et al., supra note 119.

137 Id.

138 Id.

139 Id.

140 Id.

141 Id.

142 Id.
"Loss" is typically defined to "include the amount the insured must pay for a breach of the seller's representations and warranties and defense costs."\textsuperscript{143} Buyers naturally prefer a broader definition of the term "loss," which includes consequential, incidental, punitive, and other special damages.\textsuperscript{144} Sellers, on the other hand, desire a loss definition that closely mirrors the definition in the acquisition agreement such that the policy covers all losses under the agreement for which the seller is responsible.\textsuperscript{145} Parties also should focus on provisions related to the calculation of losses, such as the effect of insurance proceeds, tax benefits, and mitigation.\textsuperscript{146}

The term "insured" may include the buyer, the seller or the target company.\textsuperscript{147} The buyer may wish to include the lender financing the acquisition as an additional insured, which should not be a contentious issue. The parties should not overlook the definition of this term, because the scope of policy coverage is sensitive to nuances in terms, such as subsidiary, control, and affiliate\textsuperscript{148}. In particular, private equity sponsors should pay close attention to whether control over portfolio companies, companies in silos, or related funds can introduce ambiguity about whether such companies or funds meet the definition of "insured."\textsuperscript{149}

5. Exclusions & Retention

R & W policies typically do not cover a range of losses, including those resulting from:

- Breaches of covenants;
- Purchase price adjustments;
- Contingent claims based on future events;
- Failure to meet financial projections and other forward-looking statements;
- Matters that are known to the insured or the insured's deal team. However buyer-side policies generally cover undisclosed breaches that may be known by the seller;
- Criminal acts, fines, and penalties, excepting some tax penalties; and

\textsuperscript{143} Id.
\textsuperscript{144} Id.
\textsuperscript{145} Id.
\textsuperscript{146} Id.
\textsuperscript{147} Id.
\textsuperscript{148} Id.
\textsuperscript{149} Id.
• Punitive damages, multiples of damages, and equitable and other non-monetary relief.\textsuperscript{150}

R & W insurance also does not cover specific categories of risk, which are typically covered by other insurance products, such as asbestos or environmental cleanup, litigation claims, or Fair Labor Standards Act violations.\textsuperscript{151} The insurer may also identify specific exclusions during the underwriting process if representations and warranties are drafted in a manner that is too buyer friendly.\textsuperscript{152}

The retention under an R & W policy serves as the insured's deductible, much like an indemnification basket in an acquisition agreement.\textsuperscript{153} Retentions generally range from 1\% to 3\% of the transaction value.\textsuperscript{154} An insured may be able to negotiate for a decrease or "step down" of the retention rate over time and which amounts are counted towards the retention.\textsuperscript{155}

6. Premiums & Dispute Resolution

Policy premiums are deal specific, but generally range between 2\% and 4\% of the coverage amount.\textsuperscript{156} Thus, an R & W insurance policy with a $30 million limit of liability on a complicated deal might cost approximately $1,200,000. As with most insurance, the premium is based on the insurer's assessment of the risk. Insurers may charge a minimum premium for smaller transactions, which explains why smaller deals often do not involve R & W insurance. The premium cost may be borne by either the buyer or the seller, depending upon who benefits the most from obtaining the insurance. For example, even if the seller is the named insured, the buyer normally pays the premium if the R & W insurance will make the buyer's bid more attractive in an auction context.\textsuperscript{157}

In regard to dispute resolution, most R & W insurance contracts provide for arbitration as opposed to litigation.\textsuperscript{158} As a result, there is a paucity of case law interpreting R & W insurance policy disputes. Insurers prefer arbitration because arbitrators in the insurance industry are generally knowledgeable and experience in interpreting these contracts.\textsuperscript{159} That being said,
many disputes resolve around whether or not a breach of a representation or warranty occurred, which may be outside of the experience of most insurance arbitrators. 160

7. Insurer Selection and Underwriting Process

The use of brokers is common in the selection process for R & W insurance. After being retained, brokers usually conduct an initial review of the transaction based on the draft acquisition agreement, high-level business summaries and the letter of intent. 161 Then, the broker will identify insurers that are capable of offering the required R & W insurance, obtain price and coverage quotes and summarize the various quotes. 162 The broker typically charges a fee based on a percentage of the policy limit purchased or some percentage of the premium, which is subject to a minimum amount. 163

Many of the large national insurance brokerages have particular units that deal only with R & W insurance. These units are normally staffed by former M & A lawyers and tax specialists, who are fully familiar with the ins and outs of M & A transactions. 164 As a result, the use of the right broker can help a buyer or seller choose the appropriate carrier for a specific type of transaction.

The underwriting process for R & W insurance has been streamlined and does not vary much across transactions. 165 The process usually lasts one to two weeks, depending on the carrier and the complexity of the deal. 166 Before an insurer commences the underwriting process, it often requires the insured to pay a non-refundable fee, which ranges from $15,000 to $50,000. 167 The fee is used to cover the insurer’s due diligence cost.

During due diligence review, the insurer will assess whether the transaction process has involved proper disclosure by the seller, due diligence by the buyer and negotiation between the parties. 168 Much like a buyer in an M & A transaction, the insurer will submit due diligence questions to the insured which ask for pertinent information relating to the deal. As a safe practice, the insured should require the potential insurer to sign a confidentiality agreement and

160 Id.
161 Id.
162 Id.
163 Id.
165 Whitney et al., supra note 119.
166 Id.
167 Id.
168 Id.
non-reliance letter to ensure the due diligence materials are not disclosed or otherwise relied on outside the scope of the underwriting process.\textsuperscript{169}

After an initial due diligence review, the potential insurer normally prepares a list of supplemental questions, which are discussed among the insured, its counsel and other advisors, and the broker. Even if this process is currently streamlined, the insurer's due diligence is important because it will ultimately affect the underwriting decision and the price of the policy.\textsuperscript{170}

If the insurer is satisfied with its due diligence review, the insurer and the insured commence the negotiation of the R & W insurance policy. Following the negotiation, the policy is normally bound at the time of the closing of the acquisition agreement.\textsuperscript{171} When the policy is bound, the insured typically pays the premium for the R & W policy in full and delivers executed copies of the acquisition agreement to the insurer. The insurer might also require the insured to deliver a disclosure letter stating that it (or members of its deal team) is unaware of any claims.\textsuperscript{172}

V. Additional Due Diligence Issues

A. State Tax Issues

There are two areas of interest at the state tax level that the franchisor must consider as part of diligence. The first is the question of whether the target's state or states will tax all of the franchise fee revenues in that state, even if the franchisor has no employees or properties previously, because of the acquisition by an affiliate. The second is the more direct element of state tax compliance by the target, and how to assure that the franchisor is not buying a state tax lien or collection case.

1. State Enterprise Taxation

States allow multi-entity groups to compute taxes and file state tax returns using several methods, known as the consolidated return (similar to federal methods of reporting, all affiliated group members file a single return, eliminating most intercompany transactions among the group, and computes tax on an aggregate basis), a separate return (each group member files a separate return and pays its own taxes), or a combined report (allocates income according to geographic source, but each group member computes and pays its own taxes).\textsuperscript{173} States allow businesses to apportion their income, if the business meets the nexus requirements set by state law and federal constitutional principles, based on the average of the ratios of in-state payroll, property and revenues to total amounts in those categories.\textsuperscript{174} What businesses are included in

\textsuperscript{169} Id.

\textsuperscript{170} Id.

\textsuperscript{171} Id.

\textsuperscript{172} Id.


\textsuperscript{174} Id.
the denominator, and how offsets can be used to calculate apportioned state income on consolidated and combined returns varies from state to state. Unitary taxation states, like California, include worldwide income from the entire enterprise, including entities that have no other nexus with the state. Whether or not a business is unitary for state tax purposes varies by state, although some common themes are "functional integration, centralization of management, and economies of scale." The Iowa Supreme Court's decision in *KFC Corporation v. Iowa Department of Revenue* upheld Iowa's efforts to impose a state income tax on franchisor KFC, even though KFC is a Delaware corporation that had no tangible assets, properties or employees located in the state. The Court rejected the physical nexus argument based on the U.S. Supreme Court's decision in *Quill Corp. v. North Dakota* in favor of the economic nexus in the context of state income taxes, following the decision of South Carolina in *Geoffrey, Inc. v. S.C. Tax Commission*. Although only a few states have followed that approach, the acquisition of a franchisee's outlets, property interests and employees, even by a sister affiliate (with common ownership), may subject the entire enterprise to state income taxation in the target's operating states. This could include the franchisor's businesses that were not previously taxed in the target's states.

A careful state tax plan is therefore needed before closing, which may be contingent upon a favorable tax ruling from the target's home state that will avoid taxing previously untaxed franchisor net income under the state income tax regime.

### 2. Local Tax Compliance

The target entity or outlets may be, and likely are, located in states other than where the franchisor buyer is located or does business. The state and local tax compliance plan and its execution by the franchisee become an important aspect of diligence, whether conducted by the client, its accountants or counsel. Depending on the nature of the business, the target's states may have activity level sales and use taxes, and more targeted taxes, which may be local but are collected by the state and remitted to local taxing authorities, typically through the sales tax administrative function. Examples are car rental taxes, hotel occupancy taxes, business zone surtaxes, and improvement district taxes supporting convention centers. These are collected by the retailer from consumers or from the buyer of an item acquired for use in the business that is not inventory held for resale, and subject to monthly or quarterly reporting and payment. State revenue bases vary and can be quite complicated to interpret. State revenue authorities typically perform random audits, so the date of the last audit, the tax years involved, any open or contested assessments and the tax years remaining open to audit are a contingent liability to be

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176 Franklin C. Latcham, BNA State Tax Portfolio No.1110-2nd, *Definition of a Unitary Business*, Section 1110.01A., BLOOMBERG BNA.

177 CCH, *Bus. Franchise Guide*, ¶ 14,518 (offering a summary of *KFC Corp. v. Iowa Dept. of Rev.*, No. 09-1032.792 N.W.2d 308 (Iowa Dec. 30, 2010)).


addressed in the indemnification section. Most significantly, state statutes attach an inchoate tax lien on assets transferred until the seller pays its sales and use taxes.\textsuperscript{180}

Most states provide a tax diligence and clearance procedure that should be observed for taxes that carry transferee liability. The buyer and seller, which may need to issue a power of attorney to obtain tax information, can request a tax good standing letter. The revenue department will issue a clearance through the date when all tax returns are filed and related taxes paid. If the tax period is relatively short between its clearance date and the closing, the tax exposure for transferee tax liabilities will be measureable and understood. The buyer should have the accounting diligence team review all state tax filings and confirm payments have been made or properly contested, with appropriate reserves maintained if the contest is unsuccessful.

States may impose surety bond requirements for businesses that collect sales and use taxes, so whether the bond is an asset conveyed at closing or released and replaced by a new bond issued by the buyer must be determined before closing. The same is true for property taxes in each jurisdiction where the outlets of the target are located. The jurisdiction may use the sale as a basis for adjusting the valuation of the outlet, and a property tax increase may follow.

At the entity level, the same questions apply to state entity level taxes as to federal income taxes. The Multi-market Seller and Financial Seller may have consolidated the target with its other businesses, so a tax-risk sharing arrangement may be necessary for tax years open to audit and assessment from any state in which the target was reported as part of a taxpaying consolidated group. The tax diligence becomes paramount, and the tax indemnity must remain effective until no further assessments can be made for all tax years ending on or before the closing date. If the seller operates in more than one state, its apportionments of income, assets and expenses may be audited and revised by one or more of its states, so those practices must be reviewed. For less sophisticated Owner/Operator entities, this may be an area of tax risk.

If the seller has outlets with a significant mail or on-line order business, their collection of taxes from out of state buyers must be analyzed and confirmed. Have they made appropriate determinations of nexus with the states in which they sell goods or perform services, and reported and paid taxes accordingly, even where they do not have a physical presence?

State and local governments offer tax incentive programs, payments in lieu of taxes, training cost reimbursements and other economic incentives in which the target may have shared prior to the transaction. The effect of a transfer of assets, assuming no relocation out of state, must be researched and understood, as the ability to relocate or close an underperforming outlet may be adversely affected.

\textsuperscript{180} See, e.g., TENN. CODE ANN. § 67-1-1444 (2015) ((a) When assets are conveyed or obligations are created by a person owing taxes to the state, on or after the date any such taxes are incurred, and such conveyance of assets or creation of obligations is in violation of the provisions of title 66, chapter 3 (fraudulent conveyance), then the commissioner may proceed to collect such tax debt from the transferee, pursuant to the provisions of this part, in the same manner as he otherwise could have collected such debt from the transferor. (b) The liability of any such transferee shall be limited to the fair market value of the assets conveyed at the time of the transfer from the original taxpayer or the amount of any such obligation at the time the obligation is created).
B. Federal Tax Audit Changes in 2018\textsuperscript{181}

Entity purchase transactions involving limited liability companies and other entities taxed as partnerships may be affected by recent changes in tax law. The Bipartisan Budget Act of 2015\textsuperscript{182} repealed the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) and Electing Large Partnership (ELP) partnership audit regimes and replaces them with a different regime. The rules will require tax adjustments to be made at the partnership level (not the partner level) following a partnership audit, which would result in an entity level tax on the partnership. These new audit rules will apply to taxable years beginning after December 31, 2017; however, partnerships may elect to have the new regime apply to any taxable year beginning after November 2, 2015. Diligence on the entity being acquired will need to assess whether the entity made the election or amended its existing partnership agreements or operating agreements to address these new audit procedures. These audit procedures will affect how future partnership agreements and operating agreements are prepared.

Under the current TEFRA audit procedures applicable to most partnerships, the IRS conducts audits of all "partnership items" at the partnership level. The IRS then individually assesses each partner for his or her share of any resulting adjustment. The TEFRA rules provide procedures for giving notice to the partners and for the partners to participate in a limited fashion in the audit proceedings. Similarly, under the ELP rules applicable to certain large partnerships which elect to have those rules apply, audits are conducted at the partnership level and assessments are made at the partner level. So, new members need not be concerned about assessments levied on departed members for tax years preceding the date of acquisition.

Under the new audit procedures, the IRS will audit items of partnership income, gain, loss, deduction, credit and partners' distributive share at the partnership level. In a significant change from the current audit procedures, if the audit results in any adjustments for tax liabilities, such adjustments will be assessed and collected at the partnership level, not the individual partner level. Interest and penalties will also apply at the partnership level for any underpayment of tax. In addition, these tax liability adjustments will be taken into account in the year that the audit is complete.

The general rule under the new procedures provides that tax liability for any underpayment of tax is calculated by multiplying the underpayment by the highest applicable tax rate, without considering the unique tax characteristics of each partner. However, partnerships will have the option to submit information to the IRS within 270 days of receiving a notice of final partnership adjustment, showing that the underpayment should be reduced due to partner-specific tax characteristics such as a tax-exempt partner or a partner subject to a lower income tax rate. That may affect franchisor or private equity fund investors who are taxed at lower rates or tax exempt.

Because tax liability adjustments will be taken into account at the partnership level and will be assessed currently against the partnership, certain partners who were not a partner in the audited year may bear the tax burden for those who are no longer partners. Congress did,


however, provide a mechanism under the new Act whereby a partnership may, within 45 days of receiving a final notice of partnership adjustment, elect to shift the burden of the assessed underpayments to the partners who were partners during the taxable year to which the assessed underpayments relate, by issuing new K-1s to such partners. If this election is made, the partners who will be required to pay the tax will also be required to pay interest on the underpayments at a rate that is two percent higher than the normal underpayment interest rate. When the tax is calculated at the partnership level, the new rules do not appear to take timing differences or net overall effect to partners into account. For example, if a partnership loss is reduced, the partnership will be taxed on the amount of the reduction even if partners have not been able to use the loss due to various limitations, such as the deferral of the loss under the passive activity rules. Also a reallocation of income from one partner to a second partner may result in a net tax to the partnership even if there is no overall net tax change because the reduction of the taxable income of the first partner is not taken into account. This means that the letter of intent and the definitive agreement must deal with this issue if the target equity is acquired and the business continues in operation.

While the new audit procedures apply to all partnerships, certain small partnerships will be eligible to opt out of the new procedures. If this election is made, such partnerships will be audited under the audit rules applicable to individual taxpayers, with any adjustments being made and assessed at the partner level. To be eligible to elect out of the new procedures, a partnership must have 100 or fewer partners and all partners must be individuals, C corporations, foreign entities that would be treated as C corporations were they domestic, S corporations, or the estates of deceased partners. Notably absent from the list of "qualifying partners" are partnerships and trusts. The Treasury Department is permitted to provide rules under which a partnership with a partnership or a trust as a partner would be eligible to opt out of the new regime, but it is unclear whether the Treasury Department will exercise this discretion. Again, the diligence must identify whether this election has been made, and it available, should it be made before closing.

Another important feature of the new audit procedures is that the statute of limitations for audits will not begin to run until the partnership has filed its Form 1065. This puts a premium on partners ensuring that their partnership timely files its tax return, and the calculation of the statute end date should be part of the diligence process.

While Congress provides a basic framework in the Act for the new audit procedures, the Treasury Department has significant discretion in implementing the new audit procedures. Until the Treasury Department releases regulations, the specifics of dealing with this issue will need to be flexible.

C. Predictive coding

Predictive coding is a process commonly used in litigation discovery review of electronically stored information by which certain word patterns, keywords, filtering and sampling are used on a number of electronically stored and scan-friendly documents to identify relevant materials. Developed for large discovery projects in litigation, the process can be applied to diligence on the records of a target entity as well. Because it is not inexpensive, and the document diligence for franchised retail outlets is usually modest, the time and expense
involved to establish the process may not be justified. However, for a service business that relies more on customer contracts rather than retail, cash or credit transactions, technologically assisted review makes more sense. For a franchisor that routinely buys its franchisees, a predictive coding plan that can be duplicated may be even more helpful and appropriate.\footnote{184 See, e.g., Christina Wojcik, Predictive Coding Going Places ... Like Corporate Contracts and M&A, SEAL (Aug. 7, 2015), https://www.seal-software.com/blog/predictive-coding-going-places-%E2%80%98lcorporate-contracts-and-ma.}

How would predictive coding work? The franchisor and its counsel would first create a "seed set" of documents that identified the key words, concepts, patterns of words and phrases that are relevant for the review. The machines then learn those relevance predictors and how to recognize them in a document. The analysis can recognize general relevance or specific issues, but sometimes multiple seed sets are needed. Once the seed set is initially specified, a test process begins, and batches of the reviewed test documents are checked to see if any relevant documents are missed or the seed set can be more sharply focused to avoid identifying irrelevant documents. Iterative learning teaches machines to be efficient and constantly improving. The process then begins in earnest, Human review of identified relevant documents measures the precision of machine identification and scores the number of actually relevant documents from the documents that are machine identified as relevant. A sampling of non-identified documents is also checked to measure how many relevant documents are missed by the machine scan, producing the "recall" score. This is usually accomplished by statistical sampling and then extrapolated.\footnote{185 Edward Sohn, Top Ten Concepts to Understand about Predictive Coding, ACC (May 22, 2013), http://www.acc.com/legalresources/publications/topten/tctuapc.cfm?makepdf=1.} While the time, energy and expense for using predictive coding isn't necessarily cost effective for a single transaction, it may play into an efficient diligence approach to multiple acquisitions of a document intensive and dependent franchise.

VI. How To Value The Deal

A franchisee's business is valued like another retail business, based on cash flow or earnings before interest, taxes, depreciation and amortization (EBITDA), a surrogate for cash flow in more complete accounting terms. The multiple of cash flow or EBITDA is a market assessment of growth potential and stability of future cash flows. Unlike franchisors, which have high growth potential but relatively unstable cash flow until their business matures, franchisees tend to mature quickly after early stage growth and in the absence of externalities like access issues for retail outlets or obsolescence of the technology, tend to have stable cash flow. Local labor markets and competition have more impact on franchisees, which may enjoy performance above a long term mean until competition for customers and resources cuts margins. The value of the franchise depends then on the assessment of where the franchise stands in its life cycle.

One investment banker interviewed by the authors\footnote{186 Amy V. Forrestal, Managing Director, Brookwood Associates, Atlanta, GA.} for this paper observed the following about transactions in the current market for operating franchisees:

- Franchisees pay more for other franchisees because they can realize the most cost savings in combining general and administrative functions.
• Private equity buyers pay a premium for franchisees with strong cash flow and unit economics, supported by a healthy, growing franchise system with good supply chain benefits, and when the private equity fund has "dry powder" in the form of expiring funding commitments by investors that must be utilized through investment or lost and restored.

• Franchisors often pay the least for the franchisee but utilize their rights of first refusal and approval rights to obtain favorable terms.

• Franchisees that own rather than lease their outlet real estate may command a premium because they benefit from rising real property values.

• Some popular, successful chains have received pricing at EBITDA multiples of 7-8; older systems may price at only 4-6 times EBITDA. Better results for older systems may be achieved by auctions rather than negotiated sales with a single preferred buyer.

• Critical factors for valuation are:
  
  o **Geography** - where is the franchisee located? Is it in a market with low costs and high rates of population growth in its key demographic groups, like the Southeast?

  o **Condition and Cap Ex** - What is the condition and renovation status of the outlets? How much capital expenditure is needed to meet system standards for renovation applicable at the time of sale or shortly thereafter? At what stage of the capital investment life cycle of the franchised business is the target?

  o **Territorial Rights or Not** - Does the target have territorial rights and protected or benefitted areas where the brand cannot encroach or populate the markets with additional outlets? How long will those rights extend? Are the target units a vanguard, a rear guard or somewhere in between in terms of brand outlet population in their markets?

  o **Direction of the Unit Economics** - Which way are the target units headed on same store sales and EBITDA? How do they compare with the brand as a whole, their region, their competitors and the segment? What gives the buyer confidence that positive directional moves will continue?

  o **Lore of the System** - how are the target units affected by unwritten customs, usage and policy about managing growth and honoring commitments that are observed by the chain management over the long term? Can the buyer rely on these traditions and lore to run its business and maintain value?

  o **Intrabrand Performance** - where does the target rank within the brand on revenue, manageable costs and occupancy costs?
One valuation expert\textsuperscript{187} believes that a franchised business has a discounted value compared with a comparable business that is not franchised. The reasons lie in the restrictions on marketing and operational practices imposed by the franchise agreement, as well as the restraints on transfer that may prevent the buyer with the highest bid from purchasing the business. To offset this discount, the franchise must contribute operational efficiencies, supply chain benefits that reduce costs, and marketing benefits that reduce overall marketing spend or drive more traffic per spent dollar than an independent business's marketing dollars would drive. The expert believes the intangible factors that otherwise affect the value of the business, namely location, customer relationships, and reputation in the market, are affected by nuances in the franchise relationship. The relevant question is whether customers would continue to patronize the business at the same level if the franchise were lost. That answer establishes the goodwill of the business independent of the franchise goodwill. The expert examines four key elements to deciding whether the franchisor or the franchisee has the goodwill value:

- **Control** - a franchise with tight operational controls and a rigid operational system derives value from the franchisor, compared with a less tightly controlled and rigid operational system, which derives value from the franchisee.

- **Advertising and Brand Recognition** - if the franchisee relies heavily on the franchisor's national and regional advertising, the goodwill factor favors the franchisor. More focus on local advertising argues for franchisee goodwill.

- **Location/Territory** - if the franchise has a good location or fertile territory, the goodwill factor favors the franchisee. If the franchise has a less desirable location or less fertile territory, the goodwill belongs to the franchisor as the business is more heavily dependent on brand recognition and referrals.

- **Franchise system rank** - if the franchise ranks above the average in the franchise system performance rankings, the franchisee goodwill is higher than a franchise with average or below average performance. Higher than average earnings mean a goodwill premium for the franchisee.

This analysis presents curious challenges to valuing the franchised business. For an Owner/Operator who will no longer manage the business but who has achieved above system average performance, the business will not likely duplicate the inspirational leadership of its founder or the goodwill attributable to its ownership. So its value in the hands of the franchisor will be less, and therefore the price may be discounted to account for weaker performance. The same factors may be true for Multi-market Seller Purchase, where the organizational efficiency or management leadership of a smaller organization causes the franchisee's performance to surpass that of the franchisor-operated units. Conversely, a franchise with institutional ownership and continuing management at the store or regional level is likely to suffer less change with franchisor ownership, so logically the discount will be less.

Bruce Schaeffer and the late Byron Fox wrote an excellent explanation of the valuation of franchised businesses that appears in the CCH Treatise *Franchise Regulation and Damages*.\textsuperscript{188} Observing that business valuations are inherently subjective and well qualified


\textsuperscript{188} Fox & Schaeffer, *Franchise Regulation and Damages*, § 20.02, CCH (2016).
experts can compute "dramatically different valuations" of the same business, courts are frustrated with the process of expert valuations. The underlying theory of valuation and appraisal rests on three principles:

1. The principle of substitution—the economic value of a thing tends to be determined by the cost of acquiring an equally desirable substitute.
2. The principle of future benefits—all values are anticipations of the future; and
3. The principle of alternatives—each party in a buy/sell transaction has alternatives to consummating the particular transaction.\(^{189}\)

There are a number of resources for more "science" on valuation. The notion of "fair market value" is a legal concept; accounting uses the concept of "fair value" to mean essentially the same thing:

<table>
<thead>
<tr>
<th>Fair Market Value</th>
<th>Fair Value</th>
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<tr>
<td>The price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts.</td>
<td>The fair value of an asset (or liability) is the amount at which that asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced liquidation sale.</td>
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<tr>
<td>Source: Internal Revenue Code § 2031 and the Regulations thereunder(^{190})</td>
<td>Source: FASB No. 142 ¶ 23(^{191}).</td>
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The determination of fair market value dates back to a seminal 1959 Revenue Ruling of the Internal Revenue Service in the context of estate and gift tax valuation of a business. The Ruling lists these factors:

(a) The nature of the business and the history of the enterprise from its inception.
(b) The economic outlook in general and the condition and outlook of the specific industry in particular.
(c) The book value of the stock and the financial condition of the business.
(d) The earning capacity of the company.
(e) The dividend-paying capacity.
(f) Whether or not the enterprise has goodwill or other intangible value.
(g) Sales of the stock and the size of the block of stock to be valued.
(h) The market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market, either on an exchange or over-the-counter.\(^{192}\)

On August 2, 2016, the Internal Revenue Service issued long-awaited proposed regulations on valuation of closely-held businesses for estate tax purposes under Section 2704

\(^{189}\) Id. at § 20.01 (citing Raymond C. Miles, Business Appraisal Theory, INSTITUTE OF BUSINESS APPRAISERS (1994)).
\(^{190}\) Id. at § 20.02.
\(^{191}\) Id.; ; Fin. Accounting Standards Bd., Statement No. 142 (June 2001). Although a good deal of No. 142 was affected by the issuance of No. 141R, this paragraph has not been superseded.
\(^{192}\) Rev. Rul. 59-60, 1959-1 CB 237, (Jan. 1, 1959). This ruling has been amplified by more recent rulings, including Rev. Rul. 68-609, 1968-2 CB 32 (Jan. 1, 1968) on valuing intangible assets.
of the Internal Revenue Code.\textsuperscript{193} The proposed regulations seek to limit the valuation discounts for minority interests in family held entities at the death of the equity holder, which were a key aspect of intergenerational transfer practices. The proposed regulations clarify treatment of limited liability company interests and their transfer within three years of the death of the decedent, and did not provide the anticipated distinction between active trade or business LLC's and passive investment entities. While on-line commentators are debating whether the IRS exceeded its statutory authority in changing, rather than interpreting, tax law,\textsuperscript{194} the commentary consistently advises that family-owned enterprises need to capture value before the regulations become effective. The IRS will hold hearings in December 2016 and the regulations will be effective on 30 days' notice after the hearings conclude. Since many franchisees are potentially subject to these regulations and their impact, the transaction pace may indeed accelerate.\textsuperscript{195}

Valuation experts and appraisers follow the methodology specified in the Uniform Standards of Professional Appraisal Practice, which incorporates the guidance of the Financial Accounting Standards Board in Auditing Fair Value Measurements and Disclosures: A Toolkit for Auditors and Valuation Approaches to Estimating Fair Value, Statement on Auditing Standards (SAS) No. 101, Auditing Fair Value Measurements and Disclosures. The methods usually require three methods - cost, income and market valuations, to arrive at the fair market value or fair value. All of these methods take the factors listed above and derive a discounted cash flow valuation of the business. Discounted cash flow takes estimates of future net income or cash flow (EBITDA) and equates them to present value by discounting at defined interest or hurdle rate.

Fox and Schaeffer suggest that the marketplace often ignores the formality of appraiser valuations for simpler rules of thumb in valuation. They observe:

Real world buyers and sellers of mid-size and smaller businesses usually don't apply either sophisticated financial theory or business appraisal methodology when deciding what price to offer or accept. Instead most will judge the value of the business by simple criteria, such as price in relation to:
- revenues
- earnings
- cash flow
- "pay back" period
- other rules of thumb (or rumors thereof)\textsuperscript{196}
- bad advice


\textsuperscript{196} Fox & Shaeffer, supra note 188 (citing Heather M. Burns Rules of Thumb: What is Their Role in Business Valuation, BUSINESS APPRAISAL PRACTICE (First Quarter 2010)).
Additionally, there is strategic value and synergistic value. However, these are buyer specific value adjustments and by definition do not conform to the definition of "fair market value," which supposes a hypothetical willing buyer and willing seller, neither under any compulsion to buy or sell. The fact that the buyer and seller are "hypothetical" precludes giving them the specific characteristics necessary to determine strategic value and synergistic value. But strategic or synergistic value should not be ignored. For example, when a franchisor reacquires a franchise, it, uniquely, reaps the additional benefit of becoming the complete owner of all the trademark rights in the granted territory. Any other buyer would be merely a licensee subject to restrictions. It is generally conceded that the ownership of all rights in a trademark in a given territory is worth more than the sum of the value of the licensor’s interest plus the licensee’s interest for the same territory before the merger of their interests. 197

Why is this relevant? Because many franchise agreements with call or similar rights require the franchisor to make a good faith effort to purchase the franchisee’s assets or business at fair market value. Call rights mean the franchisor has the right and the franchisee has the obligation to buy the franchisee’s assets, either on notice or on the occurrence of a predetermined event or a time frame. The franchisor may also build in a performance trigger, either based on below average in-system performance, or a market based approach that uses competitive data to determine if the franchisee’s outlet is performing competitively with other brands in the same business in its market. While a franchisor may include this provision in all of its franchise agreements, the forward thinking franchisor with the resources and capability to project ownership may insist on these rights for significant markets to protect the brand’s market share and take back an underperforming outlet to rehabilitate and resell. The franchise agreement or an ancillary agreement that may be recorded in title records usually specify a procedure for notice and payment terms. The franchisee is required to deliver good title to the assets and the transaction may be contingent on landlord or other third party approvals. A built in financing provision may allow the franchisor to issue a note for payment of the purchase price over time, which may be secured by the assets. The franchisor is likely to insist on a prearranged agreement with the landlord of the outlet to allow the lease to be assigned and assumed without consent as long as it is not in default.

The franchisor is in a unique position to know all of the rules of thumb that have been applied to valuation of recent sales, and whether the rules have relevant predictive value on future performance. The franchisor is also in a unique position to know what system changes may be enacted that will impact future cash flows, investment, expenses and other factors that traditionally impact the value of franchised businesses. The synergy factor is an important element to valuation, because the franchisor is in a strong position to reduce general and administrative expenses, and perhaps costs as a whole for the target through management and supply chain synergy, enabling it to pay a premium for a franchisee to net a market rate of return.

Another significant factor to consider is differential pricing and the impact on other franchisees. Why is one set of outlets priced differently than another? In the calculation of fair market value, the franchisor must have financial analysis it can share with evaluators and

197 Nestle Holdings v. CIR, 152 F.3d 83, 88 (2d Cir. 1998) ("Ownership of a mark is more valuable than a license because ownership carries with it the power and incentive both to put the mark to its most valued use and to increase its value. A licensee cannot put the mark to uses beyond the temporal or other limitations of a license and has no reason to take steps to increase the value of a mark where the increased value will be realized by the owner.").
possibly other constituencies to assure its franchisees that a franchisee is not favored or
disfavored in pricing. Notwithstanding confidentiality agreements, one should assume that price
terms and other conditions will eventually circulate and become known among franchisees,
even by a whispering campaign and perhaps as part of urban legend in the franchise community. For public companies and others who may report their consolidated financial
statements in the FDD, the purchase price or value will be disclosed. Franchisees will calculate
the value of their outlets and consider whether they want to cash in or wait for values to
improve. There is clearly information content in the price terms and simple fact of purchase.
Part of the franchisor’s public relations strategy is how to manage that information in the
marketplace.

VII. Franchisor Right of First Refusal

Most franchise and development agreements contain a right of first refusal that a
franchisor can exercise upon notification of a franchisee’s intent to transfer their franchise, and
this section is going to focus on the unique characteristics of — and best practices for — acquiring
a franchise via exercise of this right. This section will walk through franchisor best practices at
both the point when an existing franchisee has expressed an interest in selling their business,
and also, subsequently, after the existing franchisee comes to terms with their proposed buyer
and approaches the franchisor with a fully-negotiated deal. The franchisor has a role and
obligations throughout this process, regardless of whether the franchisor actually exercises their
right of first refusal.

The best practices described here will assume a certain set of facts and processes
established by the franchisor. The first assumption is that the franchise agreement spells out a
right of first refusal that the franchisor can act on when an existing franchisee proposes a
transfer of their business to a new franchisee. The second assumption is that the proposed
transfer and right of first refusal are part of either a “multi-market” or “owner/operator” asset
sale, as defined earlier in this paper. Thus, the sale is for multiple units and potentially
additional development. The agreement language, both in the franchise agreement and any
related development agreements, should be very specific, so as to avoid confusion during the
transfer process. The development agreement must state exactly what rights are transferrable.
It should state whether development rights can be transferred only if the underlying franchised
business is also transferred. It also should state whether partial rights can be transferred.

A. Early Franchisor Involvement in a Proposed Transfer

As a best practice, and as noted earlier in the paper, the franchisor should require
franchisees to notify the franchisor if the franchisee contemplates transferring its business,
regardless of whether or not the franchisor is interested in acquiring the franchise. The
franchisor must be aware of how the franchisee is marketing their franchise and confirm that all
claims are accurate. The franchisor should also be mindful of the current operations of the
franchisee and whether they have stayed in full compliance with all franchise and development
agreement obligations. The franchisor is also involved in approving any potential new
franchisees, if the acquisition by franchisor doesn’t happen.

1. Marketing Materials Review

If the franchisee plans to market their business to multiple sellers, the franchisor should
review all materials prior to marketing that the franchisee creates and intends to publish. The
The franchisor must confirm that all facts about the franchise system and the franchise agreement are accurate and ensure the franchisee is not making any claims regarding the value of their franchise that may violate franchise selling laws. The franchisor must also ensure that the franchisee is not misusing the trademarks nor making any inaccurate statements about the operations of their business. The franchisee must also clearly state in these materials all the transfer requirements that will be imposed by the franchisor, and be candid about franchisor's reserved rights and discretion. Lest a disgruntled buyer blame any misrepresentation or inaccuracy in the materials on the franchisor, a disclaimer about the review should be considered for inclusion:

Franchisor has reviewed these offering materials only for the limited purpose of assuring accurate descriptions of the franchise system, the franchise agreement and the services provided by Franchisor. Franchisor does not review, warrant or guaranty the accuracy, veracity or completeness of these materials or the information presented herein, and does not compare or audit the information presented herein against information submitted to Franchisor by Franchisee. Franchisor provides no guaranty of or contribution to the financial performance or obligations of Franchisee.

2. Transfer Requirements

Early franchisor involvement is necessary, also, because the franchisor will need to conduct a thorough review of the business to ensure both that the franchisee is in good standing under the franchise agreement(s) and that it is able to satisfy all the requirements for transfer. Many franchise agreements will require a full remodel at transfer or upgrades to other current operational standards. As the franchisee markets their business for sale to others, they must be very clear with perspective buyers all that will be required by the franchisor. The franchisor and franchisee must also resolve whether the remodels or other requirements must be performed by the selling franchisee before the sale, or whether they can be worked into the purchase agreement and price. Often the buying franchisee (or the franchisor if it elects to exercise their right of first refusal) may prefer to take on any significant renovations on their own, so that it better reflects their personal choices for their new business.

3. What Is For Sale?

One particular thing the franchisor should be aware of is whether the franchisee is promising additional development rights beyond what they own. The transfer policy should clearly state whether the franchisee has the rights to transfer only individual units pursuant to their franchise agreements, or whether the franchisee also has the ability to transfer development rights through their development agreement.

A franchisee cannot promise to a proposed buyer that they can open units within or adjacent to their current territory if that franchisee does not have the rights to that territory or the ability to transfer development rights. While further development may be a possibility for the proposed buyer of multiple units, that must be determined via direct negotiations with the franchisor. This, of course, brings into question what the price should be for the business. Can potential future development be included? The seller clearly hopes so! However, these are technically not their territory or rights to sell. They belong to the franchisor, who has sole determination over future development.
B. Right of First Refusal Process

If the franchisor plans to be actively involved in acquiring franchisees using the right of first refusal, then the franchisor is advised to have a detailed process established. The basics of this process, including timelines and legal obligations, should be spelled out in the franchise agreement. But the franchisor should also have communicated to the franchise system all the details of what will happen if they propose a transfer. See Appendix B for a sample packet that could be shared with all franchisees to share the details of the process.

1. Notifying the Franchisor of a Proposed Transfer

Hopefully, as mentioned above, the franchisor is aware that the franchisee is considering a sale of their franchise and has been actively performing due diligence. This would include evaluating the financial performance of the franchisee, considering the operational strengths and weaknesses of the franchise, reviewing all leases and long-term commitments the franchisee has made and analyzing the opportunities for future development.

If there is solid communication and an established process, the franchisee and franchisor should be regularly touching base about whether or not the franchisor is interested in the market. With proper diligence, the franchisor may even be able to either make its own offer for the franchise or be willing to waive its right of first refusal at the onset.

2. What Triggers the Right of First Refusal Process?

A right of first refusal analysis should have a strict timeline that must be followed by the franchisor. The process must very clearly specify exactly what triggers the beginning of this timeline. One important decision a franchisor must make is whether it expects the franchisee to submit an executed purchase agreement or not.

The benefits of having a fully-negotiated and executed purchase agreement are that the parties have spent time and money evaluating the deal and performing full diligence on their own; as a result, the franchisor can be confident that the parties are committed, because they have signed a deal, and the terms have been thoroughly evaluated. The franchisor can require completed schedules and exhibits, so that they have full information to aid in their analysis. This means that, ideally, the timeline for the right of first refusal analysis does not begin until a completed set of schedules and exhibits – in addition to an executed purchase agreement and whatever additional due diligence might be requested (see below) – are submitted.

The downside of requiring a fully-negotiated and executed purchase agreement is that it locks the franchisor into the terms of that agreement upon exercise, subject to any applicable language (e.g., ability to substitute cash for non-cash consideration) in the franchise agreement. The franchisor could be stuck with terms surrounding indemnification and escrow amounts that are not sufficient. In addition, there could be items included in the purchase agreement (and price) that are of no value to the franchisor, yet might have held value to the proposed buyer. This could include office space or other assets that would be valuable to a franchisee operating that business. In such situations, the franchisee could argue that the franchisor must purchase everything listed in the purchase agreement. However, the franchisor's right of first refusal should specifically state that the franchisor has the right to exercise on the specific business, as defined in the franchise agreement, but that the right does not obligate the franchisor to acquire anything outside of the specific assets used to operate the business just because they are part
of a proposed transfer. For example, if the franchised business is the operation of units (i.e. restaurants or retail locations), the right of first refusal should be limited to the locations and not anything ancillary to the deal that may be included in a purchase agreement with a third-party buyer.

If the franchisor chooses not to require a purchase agreement, the franchisor should clearly communicate — for example, in a standalone document detailing the transfer process — both the form and substance of any term sheet or binding letter of intent (which was described thoroughly earlier in this paper) it would accept in lieu of a fully-negotiated and executed purchase agreement.

Something else to consider for the franchisor is whether they should require any transfer to be completed pursuant to a form purchase agreement. This ensures that the transfer has desirable terms for the franchisor, but may not be well-received by the franchisee. It could have the downside effect of putting a damper on the market, but it could make the exercise much more smooth.

3. Additional Diligence Required

Beyond the basic requirement for a purchase agreement, the franchisor must be very clear about what diligence materials are required before the right of first refusal analysis timeline is triggered. See Appendix B. The franchisor should require financial statements from the past 2-3 years, remodel and upgrade spending, leases for all locations, income tax returns, lists of employees and current benefit plans and wage rates/salaries, copies of all vendor agreements, including marketing and promotions, and all credit or loan documents. Only after the required materials have been submitted, should the franchisor notify the seller that the timeline has begun.

In addition to reviewing the materials presented, the franchisor should make sure to contemplate why the franchisee wants to sell. Hopefully, the sale is part of a deliberate exit strategy that was long-contemplated by the franchisee, who is perhaps taking advantage of a good selling market and is ready to move on to a new business venture. The franchisor will want to analyze what the market is doing and whether there is upside potential to a purchase.

4. Analysis

The franchisor should work as quickly as possible and communicate frequently with the franchisee during the right of first refusal analysis time period. The franchisor should visit all locations and, if possible, meet any key employees that might be hired as part of the acquisition.

If the franchisor determines they are not interested, they should waive their right of first refusal as soon as possible, so the franchisee can continue their selling process.

5. Approval of New Franchisee

Concurrent with the analysis of the purchase, the franchisor must also be going through their standard approval process with the proposed purchaser. It makes sense for this process to be performed by a different team than the team analyzing the right of first refusal. The proposed purchaser must follow all the steps of applying to be a franchisee, including the application, background check and business plan. The proposed purchaser should also go
through a discovery day (e.g., a meeting between principals of the purchaser and appropriate executives of the franchisor). This concurrent approval process is somewhat of an awkward process, because during this review, the franchisor is also going through the purchase analysis. But it doesn't make sense to hold up the franchisee review unnecessarily.

C. Exercising the right of first refusal

Once the franchisor has decided to exercise its right, they should immediately notify the franchisee and proceed as quickly as possible to a closing date.

1. Adjusting The Purchase Agreement To Be Relevant For A Franchisor Purchase

Inherent in any exercise of a right of first refusal is the fact that it doesn't always make sense to step into an agreement negotiated by someone else with particular details that only pertain to that purchaser. So, the franchisor must navigate this process delicately. As much as it is able to do so, the franchisor should attempt to step directly into the current deal as the new buyer, but the franchisor will necessarily need to make some adjustments. Some examples of things that might need to change could include: overly seller-friendly representations and warranties, indemnification thresholds, escrow amounts, ability to re-hire certain key employees and allocation of the purchase price.

The franchisor could, instead, require as part of its process that the acquisition should only happen on its own form agreement. The franchisor would have to be very clear with any potential seller that this is the case in the established process.

2. Closing The Deal

It is in the best interest of the franchisor to proceed to closing as quickly as possible. They also should make sure that, during this time period, the selling franchisee maintains its required standards of operations. This includes continuing to hire new employees, performing routine maintenance and following all system standards for operation. The franchisor might need to monitor the operations more closely than other franchisees. The franchisor should also be prepared for potential issues resulting from the exercise of first refusal, which may result in mediation or litigation. Hopefully, these are avoided because the franchisor diligently followed the best practices as outlined here.

VIII. Conclusion

Acquiring a franchised business is no easy task, but the result can be more than satisfactory if all the parties know what to expect and how to prepare for the acquisition. This paper was written to point out some of the unique characteristics of a franchisor acquiring a franchised business, whether directly or through the exercise of a right of first refusal. While at first glance it might seem to be a relatively simple and straightforward acquisition, there are specific valuation concerns, diligence requirements, state and local tax implications and the commercial relationship factors that must be considered and factored into the acquisition documents and calculus.
EXHIBIT A

Representations and Warranties

1. Specialized Representations and Warranties for Franchisor/Franchisee Transactions

(a) Outlet Compliance with System Standards. Except as set forth on Schedule 3.x1, Seller is in material compliance with all current, written System Standards, specifications and procedures of Franchisor applicable to the appearance, condition, signage, operations, hours of service, [menu], [production], [service delivery], [product mix], services, [formulas], [recipes], back of the house equipment, design, furniture, fixtures, inventory, [ingredients], and operating supplies and equipment at all Outlets. No product or service not authorized by Franchisor is offered or sold by the Outlets, and all products and services required to be offered, sold and provided by franchisees under System Standards are offered, sold and provided by the Outlets to their customers.

(b) Supply Chain Sources. Except as set forth on Schedule 3.x2, Seller obtains all inventory, supplies and expendable items used in the operation of the Outlets from suppliers that are approved or designated by Franchisor as sources of such purchases, or from unapproved suppliers under contracts or arrangements that can be terminated at or immediately after the Closing without penalty. Except as set forth on Schedule 3.x2, the inventory, supplies and expendable items obtain from unapproved sources will be exhausted or used in the ordinary course of business on or before the Closing.

(c) Training. Except as set forth on Schedule 3.x3, all managers and supervisors employed at the Outlets meet current training standard certifications and qualifications of Franchisor, and all training materials used in training of Outlet employees and personnel are current editions or versions of Franchisor's applicable training materials, and Seller's records accurately reflect the training activities, test results and any remedial efforts applicable to Outlet employees and conformance to System Standards and Franchise Agreement training requirements.

(d) Marketing Activities. Except as set forth on Schedule 3.x4, all of Seller's advertising and marketing activities for the Outlets conform to current marketing campaigns, directives, standards and programs of Franchisor, and all marketing materials and advertising copy has been approved by Franchisor as and when required.

(e) Transactions, Books and Records. Except as set forth on Schedule 3.x5, all transactions with Customers of the Outlets have been effected using contract and business forms approved by Franchisor or authorized under System Standards, all transactions have been accurately, completely, timely and properly entered, recorded and memorialized in the books and records of Seller relating to the Outlets, and the books and records of Seller relating to the Franchised Business and the Outlets have been duly maintained using the chart of accounts, and with entry of all of the other transactional details required by Franchisor, in accordance with System Standards and the Franchise Agreements.

(f) Territorial and Customer Compliance. Except as set forth on Schedule 3.x6, the operation of the Outlets and the off-premises delivery of services by the Franchised Businesses conforms to the territorial and customer restrictions set forth in the respective Franchise Agreements for the Outlets, and Seller operates the Outlets in the approved locations, and
provides services in all areas where Seller is required to provide services of the Franchised Business under the respective Franchise Agreements. Exhibit as set forth in Schedule 3.x6, Seller faithfully honors all national account, loyalty, discount, and customer affinity programs required under System Standards and the Franchise Agreements for the Outlets.

2. General Representations and Warranties for Sellers and Equity Owners in Asset Purchase Transactions\textsuperscript{198}

\begin{itemize}
  \item \textbf{a. ORGANIZATION AND GOOD STANDING}
  \item \textbf{b. ENFORCEABILITY; AUTHORITY; NO CONFLICT}
  \item \textbf{c. CAPITALIZATION}
  \item \textbf{d. FINANCIAL STATEMENTS}
  \item \textbf{e. BOOKS AND RECORDS}
  \item \textbf{f. SUFFICIENCY OF ASSETS}
  \item \textbf{g. DESCRIPTION OF OWNED REAL PROPERTY}
  \item \textbf{h. DESCRIPTION OF LEASED REAL PROPERTY}
  \item \textbf{i. TITLE TO ASSETS; ENCUMBRANCES}
  \item \textbf{j. CONDITION OF FACILITIES}
  \item \textbf{k. ACCOUNTS RECEIVABLE}
  \item \textbf{l. INVENTORIES}
  \item \textbf{m. NO UNDISCLOSED LIABILITIES}
  \item \textbf{n. TAXES}
  \item \textbf{o. NO MATERIAL ADVERSE CHANGE}
  \item \textbf{p. EMPLOYEE BENEFITS}
  \item \textbf{q. COMPLIANCE WITH LEGAL REQUIREMENTS; GOVERNMENTAL AUTHORIZATIONS}
  \item \textbf{r. LEGAL PROCEEDINGS; ORDERS}
  \item \textbf{s. ABSENCE OF CERTAIN CHANGES AND EVENTS}
  \item \textbf{t. CONTRACTS; NO DEFAULTS}
  \item \textbf{u. INSURANCE}
\end{itemize}

\textsuperscript{198} Model Asset Purchase Agreement, AMERICAN BAR ASSOCIATION (2001, 2016).
v. ENVIRONMENTAL MATTERS
w. EMPLOYEES
x. LABOR DISPUTES; COMPLIANCE
y. INTELLECTUAL PROPERTY ASSETS
z. NO DATE LIMITED SOFTWARE, ETC.

aa. COMPLIANCE WITH THE FOREIGN CORRUPT PRACTICES ACT AND EXPORT CONTROL AND ANTIBOYCOTT LAWS
bb. EURO-AFFECTED PRODUCTS AND SERVICES
cc. RELATIONSHIPS WITH RELATED PERSONS
dd. BROKERS OR FINDERS
ee. SECURITIES LAW MATTERS
ff. SOLVENCY
gg. DISCLOSURE

3. General Representations and Warranties for Selling Equity Owners in Equity Transactions

a. Organization and Good Standing
b. Enforceability and Authority; No Conflict
c. Capitalization of Company and Subsidiaries
d. Financial Statements
e. Books and Records
f. Real and Personal Property
g. Condition and Sufficiency of Assets
h. Accounts Receivable
i. Inventories
j. No Undisclosed Liabilities
k. Taxes

199 Model Stock Purchase Agreement, AMERICAN BAR ASSOCIATION (2010).
I. No Material Adverse Change

m. Employee Benefits

n. Compliance with Legal Requirements; Governmental Authorizations

o. Legal Proceedings; Orders

p. Absence of Certain Changes and Events

q. Contracts

r. Insurance

s. Environmental Matters

t. Employees and Consultants

u. Labor Disputes; Compliance

v. Intellectual Property Assets

w. Compliance with the Foreign Corrupt Practices Act and Export Control and Antiboycott Laws

x. Relationships With Related Persons

y. Securities Law Matters

z. Customers And Suppliers

aa. Product Liabilities And Warranties

bb. Brokers or Finders

c. Disclosure
EXHIBIT B
TRANSFER INFORMATION AND PROCESS

BACKGROUND AND PURPOSE
Welcome to the [XYZ Company] transfer process! This packet serves as a guide to any franchisee selling your unit(s). It outlines the transfer process and assists a franchisee in achieving a timely sale of your unit(s) and is deemed part of the [XYZ Company] Operations Manual, as defined in your franchise agreements. These guidelines are applicable to a broad range of transfers by you, including changes in ownership of your business, asset sales, pledges of assets or equity, bankruptcy, insolvency, death, disability, or incapacity. These guidelines assume that the terms and conditions of our current franchise agreement apply. As a selling franchisee, however, you must consult your individual franchise agreements to determine the applicable terms and conditions, as those will control.

To be clear, [XYZ Company] ("[XYZ]", "we" or "us") does not represent the interests of either the buyer or the seller, nor will we act as agent, broker or salesperson in any such transaction. As the franchisor, [XYZ Company]'s interest in the transfer process is in protecting the integrity of the [XYZ Company] system and in protecting [XYZ Company]'s rights under the terms of our franchise agreements, which include the right to approve any transfer and a right of first refusal. We will attempt to make the transfer transaction as smooth as possible and, as such, we request that you maintain frequent communication with us throughout the process. We have no obligation to introduce prospective franchisees to sellers and are not actively involved in the solicitation of buyers for existing units.

Early on in the transfer process, you should contact [XYZ Company] to begin discussions about your proposed transfer. Each transfer is different and early communication with [XYZ Company] representatives is key. Also remember that the assignor (or "seller") must not be in default under the development agreement or any franchise agreement for the unit being transferred (or for any other unit) for any reason. If any default exists, the transfer process will be put on hold until the default is cured. Likewise, if the proposed buyer is already a [XYZ Company] franchisee, any defaults under its existing franchise or other agreements with us must be cured before we will approve the transfer to them. We reserve the right to disqualify any buyer.

We have the right to approve all assignees and can impose certain conditions to transfer, including remodeling and updating the unit, and final payment of sums owed to us, our affiliates, or vendors. [XYZ Company] will attempt to notify the assignor of any required transfer conditions when, or shortly after, [XYZ Company] provides notice to assignor that [XYZ Company] will not exercise its right of first refusal on the proposed transaction; however, the exact timeline for such notification can vary depending on a number of factors, including the number and condition of units involved.
STEPS FOR TRANSFER AND RIGHT OF FIRST REFUSAL ANALYSIS

OF YOUR [XYZ COMPANY] FRANCHISES

Pre-Transfer: We welcome any discussions about transfer as you enter the process. In particular, we need to review any information you publish for store marketing purposes that includes our trademarks and information about the system. Please forward all such materials for review at least two weeks prior to the date you intend to market the opportunity to any third-party.

[XYZ Company] Notification: You complete the Preliminary Transfer Information form and send it to the [XYZ Company] Franchise Department, with a $X deposit, payable to [XYZ Company]. This Preliminary Transfer Information form will formally start the transfer process and initiate discussions between you and us regarding a proposed transfer. We will not grant any approval based on the Preliminary Transfer Information; it is an informative step that opens communication between you and us. Upon receipt of the Preliminary Transfer Information form, [XYZ Company] will ask that you begin providing the materials described in the attached due diligence request. Consult your Franchise Agreement to ensure that you comply with all the conditions for transfer.

Right of First Refusal Analysis: You submit to [XYZ Company] an executed binding term sheet between you and the buyer, along with other information reasonably requested by [XYZ Company] including, but not necessarily limited to, the materials described in the attached due diligence request and a final copy of all marketing materials used in connection with the transaction. The purpose of the term sheet and due diligence materials is to supply [XYZ Company] with sufficient information to enable us to decide whether to exercise our right of first refusal. You should execute a fully negotiated purchase agreement if [XYZ Company] specifically requests that you do so in order for [XYZ Company] to obtain sufficient detail regarding the terms of the proposed transfer. If [XYZ Company] requests that you provide a negotiated purchase agreement, the request is not a waiver of [XYZ Company]'s right of first refusal nor is it consent to the transfer of the franchise as set forth in that purchase agreement.

Once we have received the completed term sheet or purchase agreement, if applicable, and have received and verified the content of all other requested items (including information responsive to the due diligence request), we will provide written confirmation that [XYZ Company] has received the materials necessary to begin its X-day right-of-first-refusal ("ROFR") review. The communication also will detail the date on which the X-day ROFR review commenced and the date on which the X-day ROFR review ends.

Before the end of the X-day ROFR time period, we will send a letter to you informing you of our decision regarding our right of first refusal.

Qualification of Buyer: As applicable, we will engage the prospective buyer in our franchise qualification process at the same time we assess our right of first refusal option. We will send a then-current FDD and a letter to the buyer, outlining the buyer's steps involved in the transfer of a franchise agreement. If the proposed buyer is new to the [XYZ Company] system, he or she will be required to complete [XYZ Company]'s franchise application and submit verified financial and qualifying information, not older than 60 days, to the Franchise Department. As part of the qualification process, the new buyer also will be required to visit the Home Office and share their business plan for Confidential Information. Property of [XYZ Company].
operating the acquired units. We also will discuss with the new buyer any required remodel plans necessary for transfer approval.

Note: The buyer qualification process is not subject to the same X-day timeline as the ROFR analysis. We will proceed expeditiously through the steps of qualification, but the timeline will, in part, also be dependent on the availability and information provided by the buyer. It is possible that we will waive our ROFR but the Buyer will not qualify to be a franchisee, thereby not allowing us to approve the transfer.

Transfer Approval:
1. If the transfer is approved, we will inform all parties of the approval and send an ASSIGNMENT AND CONSENT AGREEMENT. This agreement gives our consent, but it is a provisional consent only. The consent is final only upon completion of the items detailed in the agreement, which may include the following:
   a. Conditions related to remodeling, required training, sums owed, insurance requirements, releases, provision of requested financial reports, etc.
   b. Payment of the balance of the transfer fee remaining after the $X deposit (noted above), per your Franchise Agreement.
2. The transferee signs the then-current Franchise Agreement to complete the transfer.

Note: Any changes made to the terms of the transaction will trigger a new Right of First Refusal for [XYZ Company].

Exercise of ROFR: If [XYZ Company] elects to exercise its right of first refusal, then [XYZ Company] will provide you with a form of purchase agreement for the transaction. The purchase agreement will be customary for the type of transaction and will include standard representations and warranties. If we asked you to submit a negotiated purchase agreement with the proposed assignee, then [XYZ Company] will provide you with a copy of an appropriately revised version of that purchase agreement. We will then negotiate the final terms of the purchase agreement and any ancillary documents with you.

THE TERM SHEET/PURCHASE AGREEMENT

Preparing a term sheet or purchase agreement for the sale of your unit and the assignment of your franchise agreement is a complex undertaking, and it is vital to the sales transaction that it be properly drafted. We strongly recommend that you consult your legal counsel and/or your business advisor prior to preparing your term sheet or purchase agreement. This section is not intended to serve as a complete list of issues that should be addressed in a term sheet or purchase agreement, but it can be used as a guideline for issues that should be considered as they relate to the transfer of a [XYZ Company] location. The term sheet or, if requested by [XYZ Company], the purchase agreement, must be provided to us to evidence the proposed sale; however, we are not a party to the term sheet or purchase agreement and do not review it for content or detail but rather to be apprised of whether the transfer requirements are being met.

None of the provisions in the term sheet or, if applicable, the purchase agreement, may conflict with the franchise agreement, including but not limited to, provisions regarding termination, renewal, right of first refusal, or transferability. Further, the term sheet or

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purchase agreement, if applicable, should not cover the purchase of assets that are not necessary to, or that are not primarily used in, the operation of the units covered. The assets transferred as part of the transaction must be in compliance with all applicable [XYZ Company] franchise standards.

Term Sheet

At a minimum, a term sheet should address the following proposed deal terms, as applicable:
- A description of the locations and franchise agreements that are subject to the transaction;
- Proposed purchase price, form of consideration and terms of payment, and any proposed purchase price adjustments;
- Any specifically excluded assets or ownership interests;
- Any material contingencies or conditions to the proposed transfer;
- Any material covenants;
- Indemnification terms (including limitations and escrow terms); and,
- Confirmation that buyer will assume responsibility for all required upgrades and remodels once the transaction closes.

The term sheet should be signed by both parties to evidence their willingness to proceed on those terms.

Some key items that we look for in a purchase agreement (in addition to the terms described under “Term Sheet” above) are the following:
- A statement that the franchise agreement is transferable only upon satisfaction of all requirements as set out in the franchise agreement and final approval by [XYZ Company].
- The assignee assumes all obligations of the assignor under the franchise agreement or agrees to sign a new franchise agreement.
- The assignee must agree to attend and complete any training we require as a condition of transfer.
- Terms regarding the assignment and assumption of the leases (or the lease or purchase of the real property) for the units.
- Payment of the transfer fee.

SUMMARY

The preceding information is designed to answer your questions about the mechanics of transferring your [XYZ Company] locations. Please use this resource as a guide. It is designed to be educational in nature, but it is definitely not a substitute for using your own professional advisors, such as competent legal counsel, to advise you in this process.
PRELIMINARY TRANSFER INFORMATION

1. Unit
   Address(es): ____________________________

2. Open Date(s): __________________________

3. Name of Franchisee Entity: ____________________________

4. Name of Proposed Transferee: ____________________________

5. Date of Franchise Agreement: ____________________________

6. Expiration of Initial Term: ____________________________


8. If yes, how many renewal terms and what number of years? ____________________________

9. Lease Expiration Date (if applicable): ____________________________

10. Designated Area of Franchise: ____________________________

11. Remodel Plans and Costs: ____________________________

12. Please confirm the name of each owner of the franchisee entity and the percentage owned by each person listed:

<table>
<thead>
<tr>
<th>NAME</th>
<th>TITLE</th>
<th>ADDRESS</th>
<th>PHONE/EMAIL</th>
<th>PERCENTAGE OWNERSHIP</th>
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Please review the transfer conditions as set forth in your franchise agreement. Copy the pages of your franchise agreement that address transfer and attach them to this Notice.

List, if known, the name(s) of proposed transferee(s):

________________________________________

Is any Principal Owner proposing to retain a security interest in the property to be transferred? ___ Yes ___ No. If yes, which Principal Owner and what percentage? ____________________________

Other information relevant to the transfer: ____________________________

________________________________________

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<table>
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<tr>
<th>Information Requested</th>
<th>Document Available</th>
<th>Date Provided</th>
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<tbody>
<tr>
<td><strong>FINANCIAL</strong></td>
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<tr>
<td>1. Financial statements (Income Statement, Balance Sheet and Cash Flows) by quarter and full year by location for 20[●] and 20[●]. [The last two years]</td>
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<tr>
<td>2. Capex spending/additions 20[●], 20[●] and Q [●] 20[●] for all locations. [The last two years and any interim period]</td>
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<tr>
<td>3. Lease agreements (and all other related lease documents) for all locations. List of current lease expirations and lease options for all locations.</td>
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<tr>
<td>4. Detail listing of other current assets (prepaid expense, employee receivables, etc.) and other non-current assets (intangibles, etc.) as of Dec. 20[●]. [The last fiscal year end]</td>
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<tr>
<td>5. Income tax returns for the most recently available past two years for all entities.</td>
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<td>6. Copy of the company's current benefit plans (medical, 401k, etc.) and any changes made to these benefit plans in 20[●], 20[●] and 20[●]. [The last two years and the current year]</td>
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<tr>
<td>7. Copy of current hourly wage rates for each location as of the beginning of 20[●]. [The current year]</td>
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<tr>
<td>8. List of current management employees and salaries for each location as of the beginning of 20[●]. [The current year]</td>
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<tr>
<td>9. Copy of all marketing programs &amp; sponsorships (and other commitments) for 20[●] and 20[●]. [The last year and the current year]</td>
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<tr>
<td>10. List of current prototype for all locations and any 20[●]/20[●] remodel plans for each unit. [The current year and next year]</td>
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<tr>
<td>11. All credit or loan agreements, letters of credit, indentures, notes, bonds and other debt instruments and other financing instruments, and all related documentation, to which the franchisee is a party or that relate to any of its assets.</td>
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<tr>
<td>12. Copies of all other agreements that seller intends for buyer to assume as part of the transaction.</td>
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<tr>
<td>13. Copies of all materials seller used to market/&quot;shop&quot; the transaction.</td>
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- Materials must be provided as PDF or Microsoft Word or Excel documents.
• As necessary, [XYZ Company] reserves the right to modify the types of information requested.
JOEL R. BUCKBERG

Joel Buckberg is a shareholder in Baker Donelson's Nashville office and serves as leader of the Commercial Transactions & Business Counseling Practice Group. He is the co-chair of the Firm's Hospitality Industry Service Team, the practice group serving the franchise, distribution and hospitality markets. Mr. Buckberg counsels clients on business transactions and operations, particularly in hospitality, franchising and distribution, including strategic planning, development, disclosure, equity and debt financing, mergers and acquisitions, system policy and practice development, regulatory compliance and commercial contracts. Prior to joining Baker Donelson, Mr. Buckberg was executive vice president and deputy general counsel of Cendant Corporation. In his career, he has worked on the acquisition of worldwide hotel chains and their financing, de novo franchise and brand start-ups, multi-unit acquisitions, initial public offerings, hotel management agreements for existing and new build hotels, divestitures, master license grants, area development and multi-unit agreements, supply chain sourcing, distribution agreements, sales and marketing arrangements, and technology agreements.

Active in the International Franchise Association (IFA), he serves as administrator for the IFA's Franchise Compliance Training Program, a remedial educational program for violators of federal and state franchise regulations. He is a legal advisor and trainer for IFA's FranGuard compliance and business culture training program. In 2016, he was named to the Legal Eagle Hall of Fame by Franchise Times magazine, after having been selected by readers of the magazine as a franchising "Legal Eagle" for 10 consecutive years. He has been listed in Best Lawyers in America® in the area of Franchise Law since 2008, was named the Best Lawyers' 2014 Nashville Franchise Law "Lawyer of the Year," and has been named to Who's Who Legal: The International Who's Who of Business Lawyers since 2009 in Franchising.

He served as co-editor of the 2009 edition of Annual Developments in Franchise and Distribution Law published by the American Bar Association, and is a frequent speaker at IFA and ABA meetings. He is editor emeritus of Baker Donelson's Hospitalitas electronic newsletter on franchising and hospitality. Additionally, Mr. Buckberg serves as the host for the IFA's quarterly Franchise Business Network meetings in Tennessee, Louisiana, Florida, Alabama and Mississippi. He is admitted to practice in Texas, Georgia, New Jersey and Tennessee. He holds J.D. and M.B.A. degrees from Vanderbilt University, and a B.A. from Union College.

For more detailed information: http://www.bakerdonelson.com/joel-buckberg/
EMILY C. DECKER

Emily Decker is Senior Vice President, General Counsel and Secretary of Buffalo Wild Wings, Inc. in Minneapolis, Minnesota. She has served in this role since January 2010 and served as Franchise Attorney from 2007-2010.

At Buffalo Wild Wings, Emily leads the Legal and Enterprise Risk Services departments. Her responsibilities include: oversight of all the litigation and transactional matters at the company, supporting the Board of Directors and managing all corporate governance matters, supervising all insurance and claims matters; oversight of the enterprise risk management and government relations functions and serving on the Executive Leadership Team.

She also serves as the executive sponsor for the company's philanthropic efforts, particularly the Team Up for Kids campaign with Boys and Girls Clubs of America, through which the company will donate over $16 million by 2020.

She has played a key role in developing and executing the company's external growth strategy and completing over $200 million in franchise acquisitions in the past three years. She's also managed the company's investments in multiple new brands, including Pizza Rev and R Taco (formerly Rusty Taco).

Prior to her work at Buffalo Wild Wings, Emily was an associate at the law firm of Briggs and Morgan, P.A. in the Trade Regulation section, focusing on franchise, distribution and intellectual property litigation matters. She holds a B.A. in Chemistry from Duke University and a J.D. from the University of Michigan Law School.