In February of 2012, members of the Governing Committee convened to map out the Forum on Franchising’s five year strategic plan. The Governing Committee based its plan on the results of the Forum’s membership survey, also conducted every five years, to ensure that the Forum continued to fulfill the Forum’s mission to “be the preeminent forum to study and discuss the legal aspects of franchising” and to ensure that the Forum continued to find new ways to meet the needs of Forum members.

The results of the 2011 membership survey indicated that the Forum needed to focus on finding new ways to promote member engagement, improve our technology and provide for professional development and networking opportunities for our members. In response, the Forum created numerous opportunities for each member to get involved in the Forum’s Divisions, Caucuses and targeted committees. We established the Wednesday night dine-arounds for members wanting to meet and greet other Forum members. We enabled our members to stay connected with the Forum and each other all year round through the Forum’s “evergreen app” providing Forum members with daily updates on our live programming, webinars and teleconferences, links to our social media pages and the Franchise Law Journal and The Franchise Lawyer. The Forum is on the eve of its launch on the Forum’s searchable database, which will allow Forum members to research a wide range of topics from our Annual Meeting materials and other Forum publications. To help the Forum reach current and potential members in a modern format, the Forum engaged an outside marketing firm to produce advertising and promotional pieces and provide consultation on marketing approaches, resulting in new marketing materials, our online membership calendar and our annual meeting brochure. We also released the Pathways to Leadership in a written format to promote transparency in involvement opportunities. We began placing all of the Annual Meeting materials on USB flash drives, rather than CDs. The flash drive and the Annual Meeting app, along with our e-Books, allow us to reach all members of the Forum with our excellent, well-respected publications while using the most current media. We continued our discount for annual meeting registration for...

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Karen Satterlee
Hilton Hotels

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30 Years of International Franchising - Looking Back and Looking Forward

By Andrew Loewinger, Nixon Peabody and John Pratt, Hamilton Pratt

It is difficult to imagine that some 30 years ago international franchising was in its infancy with relatively few legal practitioners. In large part, that has changed, thanks to the growth of cross-border business and the significant contributions of the international franchise bar. As the only two lawyers to chair both the International Bar Association’s International Franchising Committee and the American Bar Association’s International Franchise Division, we have taken a moment to look back at how far we have come, and where we see international franchising going.

30 Years of Change in the Franchising Market

In the past 30 years, the franchise model has blossomed into a home-grown method of expansion for companies around the world—in Europe, the Middle East, Africa, South America, and perhaps most notably in Asia. For example, Kumon, the after school math and reading program founded by Toru Kumon in Japan, operates in more than 40 countries and over 1500 U.S. locations. Jollibee’s which is the largest fast food chain in the Philippines has more than 750 locations and is expanding internationally. In Guatemala, Juan Bautistia founded Pollo Campero, a fast food restaurant chain that focuses on Latin American chicken recipes. This Guatemalan chicken chain has over 300 restaurants in a dozen countries.

Internationally, new franchise systems are now being exported from areas which previously only imported franchise systems. The Middle East is producing its own luxury brands and seeking to franchise them. Asia and the Middle East are also exporters of fast food/beverage franchises. Often these are not full business format franchises. Rather, the franchise rights are acquired by citizens or entities of the country from which the franchise emanates that are living in a target country, who then develop and extend the format to the particular requirements of the country of residence.

There has been much more activity and development in international franchising than ever before, and it is occurring at a much more rapid pace than in the past. From the U.S. perspective, it is estimated that by 2020 more than one-half of all U.S.-based franchises will be located outside of the U.S. Expansion across the globe is not constrained to the food industry; there is a noticeable expansion in franchise businesses that offer services such as hotel companies, car rental companies, standardized test prep companies, and fitness clubs. Recent expansion is the result of globalisation generally and deregulations that have occurred around the world, leading to the opening of new markets in Africa, the Middle East, Russia and Eastern Europe, many of which were not active or open markets 20 years ago. Cuba is not far behind. Recent restoration of diplomatic relations between the U.S. and Cuba will inevitably pique the interest of U.S. franchisors hoping to expand into Cuba.

The recent credit crunch has undoubtedly had some negative impact on the growth of franchising. However, the impact on international franchise expansion, which to a large extent is self-funding, has been significantly less than for domestic franchising.

Much of recent international franchising has focused on three areas. First the “grey” market. It is a universal trend that populations are ageing, the willingness of families to look after their older generation is diminishing and the ability of government to fund care for the elderly is being restricted. Second, younger people in developed countries increasingly have a lifestyle involving substantial social activities outside their home so that, for instance, casual dining has increased in importance and, perhaps, as a result fitness franchises have also seen rapid international expansion. The third category is the super-rich who do not wish to clean and cook and who do not want to go to places or buy products which do not recognise their “super-rich” status. As a result luxury brands such as Marriott have sought ways to further enhance their luxury status. In London, for instance, Marriott has opened the Bulgari Hotel which is one of the most expensive hotels in the capitol. This has been created following a licensing agreement with the ultra-high-end Italian jewelry brand, Bulgari. Even in developing countries non-premium brands expanding into that country have a tendency to focus their brand on the new middle class so that, for instance, fast food franchises become mid-level brands which are attractive to the aspiring middle class.

Two further trends are discernible. The first is that...
businesses which do not franchise domestically are, nevertheless, considering franchising as a way to expand overseas. Secondly, there appears to be a shift away from franchising products to franchising services. However, in some countries, such as France, product-based franchises (particularly those relating to clothing or beauty products) continue to dominate the market.

**Explosion of Franchise Laws**

**The Evolving Regulatory Landscape**

Thirty years ago, with the exception of the U.S. and the lone province of Alberta, Canada, no country had a franchise law. The first countries to follow the U.S. in implementing franchise-specific regulations were France with the Loi Douhin (1989) and Mexico (1994). Now, today, the largest concentration of franchise sales law is in the Asia-Pacific region, where not surprisingly there is an enormous amount of franchise activity.

In 1999, Taiwan promulgated the Rule on Disclosure of Information by Franchisors, and last amended such regulations (now called the Principles for Handling Cases Relating to the Operation of Franchisors) in 2015. Also in 1999, Macau began regulating franchise agreements under the Macau Commercial Code. In 2002, the competition authority of Japan, the Japan Fair Trade Commission, published revisions to their Guidelines on Franchising. South Korea also adopted its first franchise disclosure and relationship law in 2002. Vietnam’s National Assembly adopted basic regulations on franchising provided in its Commercial Law in 2005. In 2007, China’s State Council, one of China’s highest governing institutions, promulgated its first comprehensive set of franchise regulations with the issuance of the Regulation on the Administration of Commercial Franchise. Indonesia issued and made effective its own franchise law regulations under Government Regulation No. 42 of 2007. Other countries continue to develop their franchise laws, including Australia, Belgium, Italy, Romania, Spain, Sweden, six Canadian provinces, Tunisia, and South Africa. By some estimates there are roughly 40 countries with franchise-specific (disclosure or relationship) laws of some sort.

**Opposing Regulatory Trends**

The trend related to franchise regulation has been somewhat diametrical. We have observed that there are fewer regulations in the core areas of franchising, which means fewer regulations in areas that most directly affect franchising. Generally there has been a tectonic de-regulatory shift that has gone on throughout most economies around the world in the last 30 years. Many of the areas that formerly constrained international franchising have been removed or significantly lessened. This would include such areas as: technology transfer laws that applied to franchises as a form of transfer of technology due to the intellectual property license (such laws existed in many countries such as Brazil, Japan, Mexico, and South Korea); exchange controls (e.g., in Mexico, Japan, Russia, and South Korea) and foreign investment restrictions (e.g., in Russia).

We have also observed that there is more regulation in non-core areas of franchising, which means that one of the biggest changes in international franchising reflects what has been happening everywhere: the rise and expansion of technology. Franchising has had to grasp and accommodate these technological advances; one example of this is the rise of privacy laws in franchise regulations and franchise disclosures and agreements. Ten years ago, franchisor attorneys advised their franchise clients to “watch the privacy laws.” Now, it is an essential diligence issue and in some countries, a regulated aspect of the franchise relationship between franchisor and franchisee.

**Entrepreneurial Culture and Regulations**

The two most successful franchise countries, the U.S. and Australia, have an entrepreneurial culture which is not necessarily reflected in other countries. That culture informs the approach taken to regulating franchising. In crude terms the U.S. view is that success in business is not guaranteed, some will fail and some will succeed. As a result, in the U.S. and Australia relatively high, by European standards, failure rates are not considered to be of concern. Provided that prospective franchisees are properly informed of all relevant elements before they commit, then it is not the role of government or, indeed, of the national franchise association to regulate the quality of franchisors or their members.

The European approach is dramatically different. In Europe there are powerful franchise associations who have subscribed to a code of ethics which is mandatory on members and which are enforced because of the desire to avoid franchise legislation. Generally, in those countries franchisors do seek membership of the national franchise association and, therefore, ethical standards are followed. In some cases such as the British Franchise Association, franchisees are members of the association and the association provides a mechanism for franchisees to complain about their franchisors. Added to this, in small countries, such as the U.K. where franchisees are almost always funded by one of four clearing banks who have separate franchise units, bankers, have substantial information about the success or failure of franchises and will cease to fund those systems with high failure rates which, in Europe, means any franchise failure rates in excess of 10%. In countries which take this approach, either no disclosure is required or only limited disclosure
requirements (in comparison to the requirements in the U.S.) are imposed. Further, in civil law jurisdictions (but not common law countries) the concept of good faith is rigorously applied to the franchise relationship.

The U.S. approach to regulating franchising is gaining traction and it may become the model for franchise regulation which is adopted throughout the world. The alternative view is that, although the U.S. approach had been adopted in a number of countries, the reason for that was that those countries, especially those with a colonial background, often had a sense of having been exploited by the West. As a result, they see no reason why they should facilitate exploitation by western commercial enterprises in the post-colonial era. As a result they adopt the same regulatory model as in the U.S., the major exporter of franchise systems, to prevent countries being treated as a recipient of abusive franchising practices. Under this analysis, the adoption of U.S.-style regulation is a transitional stage.

**Evolution Of Laws Relating To International Franchising**

**Franchise Sales Laws**
The first and largest change in the laws relating to international franchising has been the rise of franchise sale laws around the world. It cannot be denied that the benefit of franchising is that it provides the opportunity for everyday people independently to own their own businesses with the assurance of goodwill generated by that business’ network and the assistance from a franchisor if necessary. However, along with the benefits come disadvantages if franchisees are not properly informed before entering into a franchise relationship. The consensus among most countries across the globe that have enacted some form of franchise sale laws is that pre-sale disclosures are the best way to regulate franchising.

**Franchise Relationship Laws**
The second largest change has been the imposition of substantive requirements in franchise laws that unreasonably restrict franchising or impose excessive restrictions on the franchise relationship. Examples of some troubling requirements include the “two plus one” requirement used in China which requires a franchisor to have a minimum level of experience (two stores operating for a minimum of one year) as a condition to franchising. Indonesia has implemented an 80% sourcing requirement, which requires that franchisors and franchisees use 80% local raw materials, business equipment, and trade merchandise, and a clean break requirement which requires a franchisor to obtain a statement or judicial decision confirming that the franchisor and franchisee have settled all problems arising from any termination, before a franchisor can appoint another franchisee for the territory. In South Korea, they have implemented renewal restrictions, as well as restrictions on the proximity of new franchises to existing locations, and in Malaysia the government requires a certain percentage of franchise sales be made to native Malays. However, some countries have not been as specific about their franchise relationship laws as those previously described. Countries like Albania, Moldova, Kyrgyzstan, Belarus, Turkmenistan, Azerbaijan, Latvia, Kazakhstan, Mongolia, and the Ukraine all have issued rules to regulate franchising but do so in a highly indeterminate or ambiguous way.

**Competition Laws**
The trend in relation to competition law has been entirely positive for franchising with the Chicago School’s views winning almost universal approval in capitalist economies. Within the European Union, for instance, the Competition Directorate-General, now entirely accepts that vertical agreements, such as franchise agreements, are pro-competitive in the absence of price restraints on franchisees and market sharing. This approach is reflected in the approach of the European Union’s vertical restraints block exemption. Even the setting of minimum prices is allowed in certain limited situations.

**Commercial Agency Laws**
Particularly within the European Union, laws have been enacted to protect commercial agents who procure contracts on behalf of their principal. Very few franchises adopt a commercial agency approach but, nevertheless, in a number of civil law jurisdictions such as Germany and Austria, the courts have been willing to apply commercial agency protections in favour of franchisees with the result that on the termination of a franchise, compensation is payable to the franchisee. The argument of the civil law courts is that “by analogy” the commercial agency protections should apply to franchising.

**Civil Law Approach**
In the early days of international franchising, expertise was principally concentrated in common law jurisdictions—especially the U.S. but including Canada, Australia and the UK. This meant that many of the discussions and the approach to international franchising were dictated by a common law view. Currently, there are forty common law jurisdictions but there are 90 civil law jurisdictions and it is essential, therefore, to understand and to tailor international franchising to civil law systems. Franchisors based in common law jurisdictions will need to understand and adapt their approach to civil law jurisdictions where disclosure/discovery is very limited so that parties who
are litigating only disclose documents that are helpful to their case, cross examination has a limited role in view of the fact that cases tend to be presented in writing rather than orally, concepts of good faith have considerably greater importance than in the common law and the cost of litigation is substantially less than in common law systems.

**How the Practice of International Franchise Law Changed**

**An International Franchise Bar**

We now have the emergence of a truly international franchising bar. By this, we mean not just lawyers from many countries, but lawyers who are extremely knowledgeable about franchise laws from around the world, who have been practicing in the area for a number of years and really understand the intricacies. In addition, we have seen the emergence of the global law firm, where you have lawyers in many countries again developing franchise expertise. Finally, the existence of legal organizations with a global reach, such as the International Bar Association International Franchising Committee, the American Bar Association’s International Franchise Division, and the International Distribution Institute, have provided significant opportunities for franchise lawyers to network and connect.

**Technology**

Technology has had an enormous impact on the practice of franchise law. Deals that took months can be completed more quickly and communication is instant. Home country lawyers can more easily consult with local counsel to complete transactions, franchisors can more easily locate and communicate with franchise prospects, and increased globalisation creates an ever-increasing market for international brands.

**Global Acquisitions**

We have seen for many years many acquisitions of global franchise systems. These have been a result of sales of entire franchise systems (some of which have franchised businesses in many countries and/or some of which are acquired by foreign buyers), private equity acquisitions, and industry consolidations.

**Other Changes**

Increasingly, international franchise transactions are conducted in English and are based on agreements prepared in English. In addition, even civil law franchise agreements which historically have been much shorter because reliance can be placed on general principles of the civil code to regulate the contractual arrangements between the franchisor and the franchisee, are now adopting common law drafting styles.

A further change is that historically expertise in franchising was principally contained within private practice law firms. That landscape has changed dramatically with an increasingly large pool of knowledgeable in-house franchise lawyers who specialise in franchising. Also the knowledge of those representing master franchisees, developers and sub franchisees has increased so that it is becoming increasingly difficult for franchisors to avoid extensive negotiation of their international agreements.

**Looking Ahead**

It has been suggested that master franchising has lost or is in the process of losing its dominant position as the most favoured way to expand internationally using franchising. There has clearly been an increased willingness to investigate other expansion methods, but we see no reduction in the use of master franchising. Its formula is potentially extremely attractive to franchisors—a substantial upfront initial payment and increasing continuing fees for relatively minor involvement for the franchisor.

Having said that, the level of initial fees payable on entering into a master franchise agreement is falling. Franchisors generally can no longer charge substantial premiums over and above the reimbursement of their costs. Initial fees are, increasingly, being spread over a period of time and are linked to the opening of outlets. Master franchisees frequently argue that their limited financial resources are better spent in recruiting franchisees than making a substantial contribution to the franchisor’s coffers.

Franchisors have historically sought to impose their “home” subfranchise agreements but are now recognising that, save in very limited situations, that simply does not work. Certainly a common law franchise agreement in a civil law jurisdiction would look very odd indeed to prospective franchisees and their lawyers. Subfranchise agreements need to incorporate the elements of the home franchise agreement, but must be prepared so as to comply with custom and practice in the target jurisdiction.

Development schedules are also becoming more “realistic” and reflect market conditions in the target country. In many countries the biggest challenge for franchisors, and therefore for master franchisees, is the lack of suitable franchisee candidates who have the financial wherewithal to take a franchise.

Previously master franchise agreements were often granted for twenty or more years. Now the majority of master franchise agreements last between ten to twenty years.

As already indicated, international franchising arrangements are, for the reasons set out above, more intensely negotiated than before and there has become increasing awareness that applying the franchisor’s
“home” law/courts may not, in countries with clear and impartial judicial systems, be the best solution. Master franchisees hardly ever bring proceedings against their franchisor, because they simply adopt the self help remedy of breaching the master franchise agreement and withholding payment. Bringing proceedings in the franchisor’s home courts against a master franchisee with no assets in the home country simply wastes time and costs.

Many trends in franchise laws will continue. We foresee there being a more widely accepted recognition of franchising as a distinctive form of business. This is generally a good thing if regulations continue to allow parties to contract freely, but of course there is always the possibility that regulations could become heavy-handed which could negatively impact the industry. We may also see more franchisors start to regularly use international disclosure documents of some form as the number of franchisors expanding their franchises across borders increases.

In addition, we anticipate that some non-franchise legal developments may impact the franchise model. For example, the imposition of joint employer liability on franchisors in the U.S., the difficulty in restricting franchisee’s online sales in the European Union, and the complexity of data privacy laws around the world, may all have a significant impact on the franchise model.

*Author’s Note: This article was loosely based on a panel discussion held by the authors at the IBA/IFA Joint Conference in Washington, DC on May 18, 2016 chaired by Karsten Metzlaff of Noerr LLP, Berlin, Germany. The authors wish to acknowledge Karsten’s contributions to creating the structure for the discussion and therefore for this article. The authors also wish to thank Keri McWilliams and Nia Newton for their assistance in assembling this article.

Happy Sixth Birthday!
By Tami McKnew, Smith Moore Leatherwood

The Diversity Caucus is Six Years Old! That’s cause for celebration. Since its formation in 2010, the Caucus has enriched the Forum on Franchising, Forum members and our profession. The Caucus has ably forwarded the goals set by the Forum’s Governing Committee in 2010: to increase the number of diverse members; to increase diverse membership in the Forum’s divisions and committees; to develop a strong base of diverse writers and speakers for the Forum; and to create a growing pool of diverse members ready to assume leadership positions in the Forum. In addition to many other activities, the Caucus:

• Hosts the Diversity Lunch at the Annual Meeting. This year, our speaker will be Carlos Rodrigues-Vidal, Chair of the ABA’s Center for Racial & Ethnic Diversity. This is particularly appropriate in view of the ABA’s release of its groundbreaking reports on diversity in the ABA.
• Co-hosts the Community Service Event, with the Women’s Caucus and Corporate Counsel Division. This year’s event is at the Camillus House & Health, an overnight homeless shelter in Miami.
• Submits regular articles of interest in The Franchise Lawyer.

Last year, the Forum Governing Committee approved the establishment of the Forum on Franchising Diversity Award, to recognize a member of the Forum who has made a substantial contribution to the diversity goals of the Forum, contributed to Forum publications (specifically highlighting topics on diversity and inclusion), has a history of attendance at the annual Forum meeting, participates in the Diversity Caucus, and has shown an interest in mentoring diversity lawyers.

This year, the first recipient of the Forum’s Diversity Award will be announced at the Annual Meeting. Celebrate with us at the Annual Meeting in Miami Beach!

HAPPY BIRTHDAY!
Within the next decade, health care spending in the United States is expected to increase to $4.5 trillion, or 19.3% of the nation’s gross domestic product (GDP). NHE Fact Sheet available at www.cms.gov/research-statistics-data-and-systems/statistics-trends-and-reports/nationalhealthexpenddata/nhe-fact-sheet.html. In 2014, these figures were $3.0 trillion and 17.5%, respectively. Center for Disease Control and Prevention Health Expenditures available at www.cdc.gov/nchs/fastats/health-expenditures.html.

Spending is expected to increase at a rate of 5.8% annually over the next decade. NHE Fact Sheet available at www.cms.gov/research-statistics-data-and-systems/statistics-trends-and-reports/nationalhealthexpenddata/nhe-fact-sheet.html.

Recognizing the immense opportunity presented by these statistics, entrepreneurs and medical professionals searching for scalability for their service models have turned to franchising in an attempt to capitalize on this robust—yet still growing—industry. As of the date of this article, the authors have identified more than 100 franchise systems specializing in the offering of one or more medical services. When in-home health care and senior care services are included, that number increases to more than 150 unique franchise systems.

And yet these numbers merely scratch the surface of the opportunities available to franchisors in the health care industry in the coming decades.

Despite the prospects for significant growth, franchising in the health care industry requires a great level of sophistication and franchise systems must be designed with more flexibility than more traditional franchise models because of the added layer of complex state and federal health care laws and regulations associated with offering health care services. Simply put, complying with the wide range of complex and diverse health care regulatory requirements in addition to state and federal franchise disclosure and registration laws is complicated and expensive. But with the proper structuring and advice from experienced legal counsel, it is definitely possible.

With that in mind, this article provides franchisors and prospective franchisors with a broad overview of fundamental legal issues that must be considered when structuring and offering franchise opportunities to medical professionals or for health care services. Ultimately, franchisors who grasp the complexity of—and diligently account for—this regulatory landscape will benefit from the significant regulatory barriers to entry faced by less sophisticated franchisors who enter the health care industry but are ill-equipped to comply with the dual layers of franchise and health care regulations.

Corporate Practice of Medicine

In many respects, the single biggest barrier to franchising in the health care industry is “corporate practice of medicine” restrictions imposed by nearly every state. Simply put, these laws make it illegal for a corporate entity to employ physicians (and in some cases other licensed medical professionals) in a manner that influences the professional judgment of the physician or medical professional. These rules and restrictions may be found in a variety of locations, including state statutes, licensing requirements, medical practice acts, or common law case histories.

As a result of these laws, which can vary significantly from state to state, prospective franchisors must examine whether franchisees will be providing “health care” or “medical” services subject to the corporate practice restrictions. If the answer to the question is yes, then the franchise program must be structured in a manner which preserves the ability of the medical service provider to exercise his or her professional judgment when providing medical services.

Courts and regulatory bodies that have examined this issue in the context of franchising have opened the door to franchising by drawing a distinction between the medical advice offered by a medical professional and the business elements associated with delivering services to patients. A franchise system which focuses on developing and controlling the delivery of business services related to the patient experience, but which clearly leaves all medical decisions to duly licensed health care personnel, will likely survive a challenge based on corporate practice of medicine rules and regulations.
restrictions. Nevertheless, it is essential that experienced health care counsel examine the requirements of applicable state laws in this area prior to offering health care franchises in a particular state. To fail to do so puts both the franchisor and the franchisee at risk.

**Fee-Splitting**

A number of states have laws prohibiting medical professionals from sharing any portion of patient fees with non-medical entities or business personnel. These restrictions can preclude payments for referrals or prohibitions against sharing medical fees with anyone other than the partners with whom a physician practices. Many states have extended these restrictions beyond doctors and now include a variety of other medical professionals, including chiropractors, nurses and dentists. In most cases, the types of procedures offered by the franchisee will determine the applicability of these statutes. However, the general rule is that, if the procedure must be administered by a licensed health care professional, such administration is considered the provision of medical services and will likely be subject to fee-splitting prohibitions.

Designed to ensure that medical professionals are not confronted by the “divided loyalty” dilemma—meaning that the physician’s medical decisions for a patient are influenced by the physician’s own financial interests—these restrictions can present real challenges for franchisors trying to structure a health care franchise based on the traditional franchise model. The key to addressing this issue is to evaluate whether state fee-splitting laws are applicable based on the medical professionals providing services to the patients or customers of the franchisee. If one or more laws are implicated, the business basis for payments made to the franchisor should be clearly spelled out in the franchise agreement, and payments should not be tied to the gross revenues generated or profits earned by the medical professional or the volume of cases performed or referrals received by the medical professional. Payments made on a fair market value basis or flat-fee arrangements supported by documentation establishing the value of the service provided by the franchisor are much more likely to withstand regulatory scrutiny.

**Physician Self-Referrals**

The federal law known as the Stark Law; 42 U.S.C. §1395nn(a)(1)(A) (2012), and the various state laws known as “mini Stark Laws,” prohibit doctors from referring patients to entities in which the doctor owns a financial interest. The federal law outlines twelve specific categories of services, and it applies only where the services provided by the doctor are reimbursed by Medicare or Medicaid. Many of the various state laws go further, and in some cases prohibit self-referrals regardless of the payer or require referring doctors to disclose their financial interests to their patients.

These laws impact the franchise model because, depending on the nature of the health care service to be offered by the franchisee, they may effectively restrict doctors from owning an interest in the franchisee entity. If the franchise model is dependent on referrals from doctors in order to generate patients or customers for the franchisee, the pool of potential franchisees may be significantly narrowed in states that ban all self-referrals. In states that require disclosure by doctors of financial interests in entities to which they refer patients, it is critical that the franchisors work with health care counsel to ensure the proper disclosures are made at the required time. If the franchise model includes the payment for services by Medicare, Medicaid, or a similar state program, the franchisor must be sure to structure the model in such a way that the franchisee and its referring physicians can comply with the Stark requirements.

**Anti-Kickback Regulations**

The federal Anti-Kickback Statute prohibits direct compensation for patient referrals for services covered by federal programs like Medicare and Medicaid. 42 U.S.C. §1320a-7(b) (2012). Drafted broadly and interpreted even more expansively by the courts and regulatory bodies, the program is designed to prohibit giving any type of cash payment or in-kind benefit to doctors in exchange for referrals.

Unless the franchise business model includes payment from federally funded programs, the federal Anti-Kickback Statute is likely inapplicable to most franchisors. However, it is important to have counsel analyze the issue because violating the statute is a felony which carries both a hefty fine and imprisonment up to five years.

**Privacy Laws**

Because of the intensely private nature of health care services, and the financial and emotional ramifications for patients if their medical information is released to an unauthorized party, a number of laws have been passed at the federal and state level to protect the privacy interests of patients. At the federal level, the Health Insurance Portability and Accountability Act of 1996 (commonly referred to as HIPAA) imposes specific privacy obligations on franchisors operating in the health care industry that have access to patient information through a franchisor-sponsored intranet or by having access to franchisee files. A franchisor governed by HIPAA needs to determine the extent of its obligations early on and to develop a HIPAA compliance plan.
A number of states have developed and implemented laws protecting patient privacy, data privacy, and financial privacy at the state level as well. Because these laws are not consistent, it is critical to develop a plan as the franchise operation is being formed that will ensure that franchisees will comply with their obligations to protect patient privacy at the state level. In addition, the franchisor will need to develop a mechanism to monitor changes in these laws as they evolve over time.

**The Latest Development – Franchise Regulatory Resistance**

When considering a medical franchise model, franchisors also need to scrutinize the level of resistance from the state’s medical licensing authorities and how such resistance may impact the state’s franchise regulatory agency. California’s Medical Board is a case in point. California’s Medical Board takes a stern approach to the corporate practice of medicine and has issued guidelines that are regularly applied by the California Department of Business Oversight when determining whether to register a health care franchise. The California Medical Board’s guidelines extend to restrictions on unlicensed individuals making business or management decisions, including through management service organizations. See Corporate Practice of Medicine, The Medical Board of California, available at http://www.mbc.ca.gov/Licensees/Corporate_Practice.aspx. Examples include approving or selecting medical equipment and advertising, both common practices in franchising.

The protectionist approach applied by the California Medical Board has resulted in a heightened review by the California Department of Business Oversight. As such, when structuring the franchise model and applying for registration in any state where there is increased scrutiny for medical franchises, it is important to understand the licensing board’s interpretation of relevant statutes as well as the interplay between the licensing board and the franchise regulatory agency.

**Conclusion**

Because of its significant growth potential and the tremendous revenue involved, the health care industry presents significant opportunity for the franchise business model. But, unlike most other industries served by franchisors, the providers offering medical services are governed by a complex layer of federal and state regulations. Franchise professionals looking to expand in this arena need to combine forces with professionals experienced in the medical field in order to avoid the landmines that await the unwary franchisor. Similarly, franchisors must seek the counsel of lawyers who understand the regulatory environment and the franchise business model in order to navigate the regulatory waters of the health care industry. To fail to do both risk dooming the franchise enterprise to a diagnosis of “dead on arrival.”

**MEMBER SPOTLIGHT**

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**Hobbies:** Photography, painting (watercolor, oil, pastels), and drawing (graphite and ink).

**Something people would be surprised to learn about me:** Before I became a lawyer, I was an artist and art teacher in New York City.
Refranchising: Not Just Another M&A Deal
By: Kevin E. Maher and Richard L. White, Baker & McKenzie LLP

Over the past several years, numerous franchising systems have engaged in ambitious refranchising programs in an effort to transform and grow their brands. Refranchising involves the sale by a franchisor of one or more company-owned units to a third party to operate the business going forward as a franchised unit. While franchisors often make one-off sales of underperforming or non-strategic company-owned units, launching a chain-wide refranchising initiative is often a transformative measure representing a philosophical shift in the franchisor’s approach to development. A system-wide refranchising initiative is often driven by a desire to shift financial risk away from capital-intensive company-owned units (and the related corporate overhead and balance sheet exposure they entail) to a more cash-flow friendly and profitable royalty stream. Often, a refranchising deal is accompanied by the execution of a multi-unit development agreement requiring the refranchise purchaser to develop an agreed number of additional franchised units within a defined territory—shifting the burden of continued market growth from the franchisor to the refranchise purchaser.

Shifting the balance in favor of more franchised units and fewer company-owned units also means that a franchisor must think even more strategically about the value the franchisor is providing to franchisees. The paradigm shift from brand owner with readily apparent “skin in the game” to a brand owner with more limited unit-level operations may raise questions for existing franchisees and refranchise purchasers. A brand engaged in a system-wide refranchising program may need to simultaneously redouble its efforts in terms of brand development through an enhanced focus on new product ideas, system improvements, promotions and ad campaigns aimed at increasing unit-level sales for its franchisees (and thereby increasing its royalty base). This allows the brand owner to become less distracted by the day-to-day operation of units and more focused on the strategic evolution of the system for the benefit of the entire franchise network.

Moreover, overlaying a long-term franchisor-franchisee relationship on top of the buyer-seller relationship creates a unique dynamic that does not exist in a typical asset or business sale transaction. In a typical asset or business sale transaction, a bridge-burning approach might be possible because the relationship between the parties after closing may be limited to some nominal transition matters and waiting out the indemnification survival period. By contrast, a truly successful refranchise transaction involves a mutually beneficial long-term relationship, making the balance between appropriate seller protections and franchisor-franchisee harmony difficult to achieve.

This article examines some of the key documents and other considerations that are unique to refranchise transactions and that distinguish the way in which a franchisor sells a business to a franchisee from how a typical seller would approach documenting, negotiating and closing the sale of its business.

Pre-Sale Due Diligence
Prior to entering into discussions with a potential refranchise purchaser regarding a potential transaction, the franchisor should have an in-depth understanding of the franchise units being sold and the potential diligence issues that are likely to arise in the refranchise transaction. Such issues have the potential to materially affect the valuation, sales process and legal documentation of the transaction. Some of the most commonly encountered due diligence issues include: lease terms and real estate control, liquor licensing, deferred maintenance issues, litigation, environmental issues and employee benefits. A thorough pre-sale due diligence process allows the franchisor to proactively address known issues prior to even signing a letter of intent (“LOI”), rather than dealing with concessions later in the negotiations when the franchisor’s leverage is reduced. Three critical diligence issues involving potential consents from third parties are:

- **Lease Terms**: The franchisor and its counsel should have a clear understanding of the assignability of any real property leases prior to initiating the proposed refinancing transaction. The franchisor should also understand whether a continuing guarantee of the franchisor is required in connection with a proposed lease assignment or if the landlord is likely to release the franchisor from liability in connection with an assignment.
- **Liquor Licensing**: To the extent the franchised business involves the sale of alcoholic...
beverages, the franchisor should consult local liquor counsel well in advance of the transaction in order to adequately address such matters and define an appropriate timeline for closing of the refranchise transaction. The regulatory scheme for liquor licensing matters can vary greatly from jurisdiction to jurisdiction and various licensing arrangements may exist that can affect the timing for closing or the risk of liquor liability to franchisor.

- **Deferred Maintenance**: The franchisor should have a thorough understanding of the physical condition (including any deferred maintenance issues) of the premises and assets it is selling, as a buyer conducting physical due diligence may discover potential repair issues. In addition, some deferred maintenance issues may be the responsibility of a landlord requiring pre-sale negotiation with the landlord, which can take time to negotiate and is best done prior to entering into discussions with a refranchise purchaser. The franchisor should require the refranchise purchaser to conduct inspections and other due diligence with the clear understanding that the refranchise transaction is on an “as is, where is and with all faults” basis. This is especially important for the health of the relationship between the parties immediately before and after closing, as franchisor does not want the refranchise purchaser to raise deferred maintenance and other asset condition issues on the eve of closing or immediately after closing.

**The Non-Disclosure Agreement**

Discussions around any refranchise transaction must begin with a strong non-disclosure agreement (“NDA”) with the prospective refranchise purchaser—particularly when these discussions involve a refranchise purchaser that is not an existing franchisee. In one sense, this is no different than the approach a franchisor would take in selling a franchise. However, there are additional sensitivities involved when discussing the sale of a company unit. First, the refranchise purchaser will want access to detailed financial reports on the franchised units to be acquired. This may be particularly sensitive information to the franchisor (especially when dealing with underperforming units) that it would not want to be disclosed if a proposed transaction is not ultimately consummated.

Second, the mere knowledge that the sale of company-owned units is being considered may have immediate negative consequences to the business—in particular, in relation to the employees of the affected units or corporate employees who may not be privy to the pending transaction. Accordingly, the franchisor should include an express non-contact provision requiring all communications regarding the proposed transaction to be directed to a specific franchisor employee in charge of the transaction and a prohibition on contacting franchisor’s employees, suppliers, and landlords, except as specifically authorized by franchisor in writing.

Additionally, not only should the NDA protect against disclosure of the transaction itself, but the franchisor may want to include non-solicitation provisions covering, at a minimum, its key employees and general managers of company-owned units, senior managers, and executives. The franchisor may ultimately be happy to have the refranchise purchaser hire certain employees in connection with a refranchise transaction; however, the franchisor will want to ensure that none of its employees are “poached” by the refranchise purchaser if they would have an important role in the franchisor’s organization going forward.

**The Letter of Intent**

While every LOI necessarily addresses a number of key business and legal terms (i.e., non-binding until definitive documentation is executed, franchisor may withdraw from discussions at any time, etc.), in the refranchise context it is critical that the LOI include other terms, such as:

- The specific franchised units to be purchased and, if possible, the purchase price allocated to each unit;
- The initial franchise, royalty and other fees to be charged for the franchised units;
- Any required remodeling, redecorating or renovation of the franchised units to be purchased, including detailed information regarding the minimum and maximum expenditures and schedule for completion;
- If applicable, a development schedule setting forth the additional franchised units to be developed in the restricted territory by the refranchise purchaser;
- Given the franchisor and refranchise purchaser will be entering into a long-term relationship post-closing, it is critical that the parties have a clear understanding that the franchised unit is being sold on an “as is, where is and with all faults” basis with limited franchisor indemnification. The scope of indemnification should be clearly defined so that the parties have an understanding of post-closing responsibilities and are able to avoid (to the extent possible) protracted disagreements that could
adversely affect the franchised unit and the ongoing relationship between the parties; and

- To the extent applicable, any agreed exclusivity period and an acknowledgment by the refranchise purchaser that it will be responsible for all of its own costs and expenses in connection with negotiating and documenting the proposed transaction.

**Definitive Purchase Agreement**

Refinancing transactions are frequently documented using an asset purchase agreement (“APA”) between the franchisor and the refranchise purchaser. As with any purchase transaction, key terms—particularly those relating to purchased assets, excluded assets and assumed liabilities—must be properly defined.

The “Purchased Assets” definition should be limited to include only those assets utilized solely in connection with the franchised units. Ideally, the franchisor should endeavor to include only assets set forth on a schedule within the definition of “Purchased Assets.” In addition to furniture, fixtures and equipment, it is also typical to transfer franchisor’s leasehold interest in specified leased properties, certain scheduled contracts, and, to the extent transferable under applicable law and at no cost to the franchisor, certain licenses and permits.

- The “Excluded Assets” definition should, among other things, expressly acknowledge that all rights provided by franchisor with respect to the franchised units (including, without limitation, the trademarks and the franchisor’s system and goodwill associated therewith) remain the property of franchisor. The definition should also clearly provide, among other things, that all benefit plans and employee or personnel files, all insurance policies, all rights under contracts not expressly assumed by the refranchise purchaser, and any proprietary software remain the sole property of franchisor.

- Franchisors typically assign the lease or sublease the real property utilized for the franchised location to the refranchise purchaser. If the franchisor will not be released upon assignment, then the franchisor should require the refranchise purchaser’s principals to deliver a guarantee to the franchisor guaranteeing the refranchise purchaser’s obligations under each assigned lease or sublease.

- The APA should include an express acknowledgment by the refranchise purchaser that it is purchasing the Purchased Assets on an “as is, where is and with all faults” basis. The APA should also include an acknowledgment from the refranchise purchaser that, except as otherwise specifically set forth in the APA, the franchisor is not making any express or implied representations regarding the Purchased Assets. Because franchise relationships can be a 20 or 30 year prospect, the parties must clearly understand their rights and responsibilities from the outset. While clear disclosures by the franchisor regarding the condition of the Purchased Assets is critical, it is just as critical that the refranchise purchaser value the transaction with this in mind to avoid future disagreements that could damage the ongoing franchise relationship.

- The APA should explicitly address the refinancing purchaser’s obligations to the franchisor’s current employees at the franchised units. To mitigate the risk of potential employment liability for both parties, qualified employment counsel should be involved to review the structure of any transition of employees from the franchisor to the refinancing purchaser, including the terms of employment offered to the affected employees (i.e., whether commensurate salary and benefits will be provided, whether accrued vacation will be honored, etc.) and any release, transfer or termination documentation. The APA should also require that the employee transfer be appropriately structured to avoid the application of the federal Worker Adjustment and Retraining Notification ACT (“WARN”) and any state equivalent or, to the extent WARN or a state equivalent is applicable, that the refinancing purchaser will ensure compliance with the duties and obligations associated with the transaction.

- As referenced above, if the franchised business involves the sale of liquor or other alcoholic beverages, the parties will need to coordinate closely with local liquor counsel. In some jurisdictions, temporary or conditional liquor licenses or the entry into interim beverage management agreements may be necessary.

- Indemnification in the refinancing transaction context is unique given the ongoing relationship between the parties following closing. Because the refinancing purchaser is buying an operating business along with furniture, fixtures and equipment, it will want to look to the franchisor if issues arise post-closing. However, as noted above, the LOI should clearly provide that the purchased assets are being sold on “as is, where is and with all faults” basis. Consequently,
the franchisor should consider reasonable liability caps and baskets for any indemnification, and the parties should reach a clear understanding that the ongoing franchise relationship may not be used as a negotiation tool in connection with post-closing indemnification.

Changes to the FDD

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Disclosure Documents

In addition to the transaction-specific documentation described above, initiating a systematic refranchising program requires changes to the Franchise Disclosure Document (“FDD”) to address the refranchising program and its effects on the franchise system, including:

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Summary

Many franchisors have embarked on refranchising programs with the goal of changing their business model, often with a complementary goal of expanding the reach of the brand and the franchise system. The process of transforming the franchisor from a chain owner with significant capital investment to a strategic developer of a brand system, new product producer and marketer presents significant opportunities but also numerous pitfalls and risks. As outlined above, a successful refranchising program requires advance planning, careful due diligence, coordination and, not to be overlooked, execution of key legal documents that define the rights and obligations underlying a long-term, mutually beneficial relationship. The factors inherent in a refranchising transaction require the franchisor not to view the refranchising transaction as an ordinary M&A transaction, but part of a larger systemic change and realignment for the franchisor and its brand.
first and second time attendees and those under 36. We expanded our programming for both corporate counsel and international practitioners including a special dinner event for members signing up for the international intensive.

Once again, in February of 2017, the Governing Committee will convene to map out a new five year strategic plan for the Forum. The challenges facing the Forum today are much different than they were five years ago. First, the ABA is shifting responsibilities for several functions, such as publications and marketing, to the Forum. In order to remain the preeminent forum to study and discuss the legal aspects of franchising, the Forum must map a path forward to assume financial responsibility for production of all Forum publications, the Franchise Law Journal and The Franchise Lawyer as well as other services the Forum provides its Members related to the Annual Meeting. In addition, as many of our members become more experienced in their practice, the Forum must find ways to appeal to younger members of the bar, including millennials.

Please do not hesitate to reach out to me directly with your suggestions for future of the Forum by e-mail at Karen.Satterlee@Hilton.com or in person when we gather at the 39th Annual Forum on Franchising in Miami, November 2-4, 2016. I look forward to seeing you in Miami.

Message from the Chair
Continued from front cover

Fall is a time of new beginnings in my house. A new school year for my daughter, a new football season for my beloved and often underachieving college football team, and renewed energy for the practice. And this year, there is a new challenge for me as the Editor in Chief of The Franchise Lawyer.

I take the baton from the incomparable Corby Anderson, who has helmed The Franchise Lawyer for the past three years. Corby introduced a number of features to The Franchise Lawyer, including the “Diversity Dialogue,” “Member Spotlight” and the “Corner” feature that rotates between litigators, transactional and corporate counsel. Hers will be a tough act to follow, and I look forward to the opportunity to continue her excellent work. Please join me in extending a hearty thank you and best wishes to Corby.

In this issue, we have a look back and forward at international franchising written by Andrew Loewinger of Nixon Peabody and John Pratt of Hamilton Pratt, the only two lawyers to have chaired both the International Bar Association’s International Franchising Committee and the American Bar Association’s International Franchise Division. Jennifer Wisniewski writes on pointers and pitfalls for companies contemplating franchising in the complex healthcare industry.

Kevin Maher and Richard White of Baker & McKenzie offer practical advice to franchisors contemplating refranchising as a growth strategy.

We also wish a happy birthday to the Forum’s Diversity Caucus, which has worked hard to increase the diversity of the Forum. And we will meet Los Angeles practitioner Marty Fern in this issue’s Member Spotlight.

The Fall issue is also a new beginning for Erin Conway of Garner & Ginsburg, who joins The Franchise Lawyer as an associate editor. She joins Karen Marchiano of DLA Piper, Keri McWilliams of Nixon Peabody and Matthew Gruenberg of Barnes & Thornburg on the editorial staff. I am grateful for everything they have done to ease the transition and make this issue possible. And, of course, publication of The Franchise Lawyer would not be possible without the efforts of the staff of the American Bar Association.

I look forward to the next three years with The Franchise Lawyer and hope I see you all in Miami.

Message from the Editor in Chief

Heather Carson Perkins

Heather Carson Perkins
Faegre Baker Daniels
Collateral Issues in Franchising: Beyond Registration and Disclosure
Edited by Kenneth R. Costello

In addition to counseling their clients on disclosure, registration and other basic franchising concepts, franchise attorneys handle a wide variety of “collateral,” but essential, areas of law on a daily basis. These can range from internet communications to advertising programs to supply chain issues. In this book, each chapter addresses a category of concerns and offers insightful analysis of important aspects of the franchisor-franchisee relationship.

Topics include social media, search-engine optimization and other internet concerns; franchise sales relationships; third-party financing; the franchisor’s corporate and business structure and intellectual property; real-estate issues such as zoning, permits, building code compliance, signs, environmental issues and due diligence, and real estate financing; regulation of advertising and telemarketing; and supply chain management and logistics; among others.

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