Global Franchise & Supply Network

2025 REPORT

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Contents

Introduction 2

2024 Recap of Franchise Developments and 2025 Trends To Watch 3

What Do These Common Contractual Words Actually Mean? 11

Trends in Mediation 16

California Enacts New Franchise Broker Law 19

Merging Franchise Systems: What To Share and What To Separate 24

Disclosure Implications When Combining Franchise Systems 26

How Franchises Have Handled Investments From Public Figures — A Review of Item 18 29

While 2024 saw more stability in the financial markets than 2023, many challenges arose in 2024 for franchised businesses, manufacturers and retail chains, including bankruptcies of many large restaurant and retail chains, leadership changes, increases in food costs, labor shortages, regulatory changes, disparate buying-power among customers and shifting consumer behaviors. We expect 2025 to welcome a stronger economy and more M&A activity in the retail and franchise space but expect many of these trends to continue.

In 2024 there was a continuing push for the Federal Trade Commission (FTC) to amend the FTC Franchise Rule with the FTC expressing interest in the "fairness" of the franchisor-franchisee relationship, charging of non-disclosed "junk fees" and the potential stifling effect of anti-disparagement and good-will provisions on franchisee complaints to the FTC; there was a lack of clarity and continued changes across federal agencies and the courts concerning the standards to determine joint-employer status and misclassification; there were federal and state challenges to the validity and enforcement of non-compete covenants; and there were challenges to the viability of the Corporate Transparencies Act, all of which have continued or will likely continue to be challenges that will affect franchising in 2025.

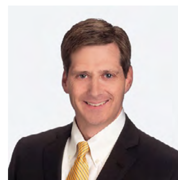
With the U.S. election outcome uncertainty passed, the unpredictability of the incoming administration persists. A combination of proposed polices including tariff and immigration policies could inhibit growth. The effects of likely de-regulation and changes in fiscal policies are unknown. At the same time, many economic pundits predict a return to "normalcy" as to inflation and, ultimately, to growth.

We see tremendous activity in the supply chain area as brands and suppliers no longer can prioritize best pricing and on-demand delivery above building a more resilient digital network for product manufacturing, distribution and transport. As trade, taxes and tariffs are a huge priority for this next presidential administration, economies of scale and cross-border trade will likely be greatly affected in 2025.

Given the economic outlook and franchisors' and retailers' continuing need to navigate complex supply chain issues, manage the expectations of franchisees, resolve disputes, implement new technologies, systems and processes and provide goods and services to keep up with competition and adapt to changes in consumer demands, we have selected the timely articles contained in this report to highlight many of the business areas impacted by the changes in the last year and the forward-thinking advice and counsel on such subjects our attorneys provide our clients throughout the year. In the articles that follow, Len MacPhee provides an overview of many of these developments and their respective status, while Joyce Mazero outlines some key considerations in improving contract drafting by using and defining important terms, as well as franchise mediation/conflict resolution pointers. Jess Dance discusses the new California franchise broker disclosure law, while Jarina Duffy outlines disclosure issues arising out of franchise system mergers and acquisitions as well as discusses opportunities to combine back of the house and other functions for brands post-closing and Josh Goldberg provides insights into celebrity involvement in franchise sales and promotion.

We are excited to see what the future brings for all of us and we look forward to having the privilege of assisting you in shaping that future in 2025.

Joyce Mazero
Global Franchise &
Supply Network Co-Chair



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2024 Recap of Franchise Developments and 2025 Trends To Watch

Len MacPhee
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There were a number of important and potentially impactful developments in 2024 that we predict will continuing developing and trending in 2025. Some of these topics are also discussed in other articles in this annual update. The below lists a few additional trends from 2024 to watch that will impact franchise law.

Amendment to the FTC Franchise Rule and Related Franchise Relationship Issues and Disputes

The Federal Trade Commission's (FTC) efforts to amend the FTC Franchise Rule (the Rule) will continue in 2025. While we continue to expect some changes to the current disclosure requirements, and we suggested some changes to the FTC in response to its request for information (RFI), we anticipate focus in 2025 to be on efforts to add federal regulations governing relationship issues and not just to make changes to the existing disclosure requirements. After a long comment process in which the FTC showed its interest in multiple relationship issues, in July 2024 the FTC issued a report (the Report) with a request for additional comments on certain relationship issues and an extension of the comment period through October. The FTC board also issued a policy statement and FTC staff issued guidance on relationship issues that show the direction and likely areas of focus.

In its Report on its findings to date, which it stated were based on some of the comments received in response to its RFI, the FTC listed several relationship issues that it found to be the most prevalent potential needs for rulemaking. Two of the top three issues related to system changes and new or increasing fees that are often imposed by franchisors through changes to the operations manual. The FTC described complaints from franchisees and its concerns with franchisors adding fees for new technology and new services when those services and fees were not disclosed in the Franchise Disclosure Document (FDD) or provided for in the franchise agreement. We, too, have found that this is a growing tension in many systems and predict that franchisors and operators will experience much more activity navigating disputes in 2025, and that this will be a continued focus of the FTC and in states with existing franchise relationship laws.

In the staff guidance issued on the same day as the Report, FTC staff stated that they interpreted the existing FTC Act as preventing franchisors from imposing fees on franchisees that were not disclosed in the franchisor's FDD and provided for in the franchise agreement. The staff provided this guidance in direct response to the above-noted franchisee reports of ever-increasing fees, including processing and technology fees and fees for training, marketing, property improvement and other product or added services required by the franchisor. The staff guidance opines that it is illegal for franchisors to impose such undisclosed fees — what the FTC calls junk fees — and the staff repeated several times its concern that such new

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undisclosed fees may raise costs and be the difference between a profitable franchise and an unsustainable one.

The challenges of meeting consumer demands and competition through innovation and technology, which are essential to staying competitive but also add costs and fees, will be a major issue in 2025. This tension in many systems is mounting as brands incur the research and development costs necessary to employ much-needed new technology and upgrades and then attempt to mandate it to franchisees with some level of corresponding fees to pay for the costs by the operators and franchisees. Franchisees often want the technology and new services, but not the added fees hitting their operating costs. While the expectation often is that the added service or technology will increase revenue as much or more than the increase in fees and costs, that is not always the case, nor is the revenue as immediate as the added costs and fees. Who should pay the higher costs and added fees necessary to keep up with competitive pressures and customer demands? This will remain, and we predict grow as an issue in 2025. The FTC communications, if not direct actions, in 2025 will enhance the immediate nature of this growing tension.

In addition to the FTC's issuing the Report and reopening the comment period, and the FTC staff providing the staff guidance, the FTC board also issued a policy statement warning that franchisors' use of contract provisions, including non-disparagement clauses and clauses that prohibit franchisees from engaging in conduct that harms the brand's goodwill, violate the FTC Act if used to stifle franchisee communications to the FTC and other government bodies. The statement emphasized that franchisee reports and voluntary interviews are a critical part of FTC investigations, and franchisees' reluctance or inability to file reports and discuss their experiences may hamper the agency's work to protect franchisees. The board also reiterated that threats of retaliation against a franchisee for reporting potential law violations to the government are unlawful.

These statements coupled with the topics on which the FTC requested comments demonstrate an interest to add the Rule's relationship issues.

Additional franchise relationship issues and trends that we anticipate will continue and increase in 2025 include claims and disputes over the estimated initial costs in Item 7 and over renewal conditions. We saw both of these relationship issues rise with an increase in the number of claims and disputes between franchisees and franchisors. The FTC included renewal conditions in its top 12 list of key issues raised by franchisees, as well.

Noncompete Covenants

The enforceability of noncompete covenants is a front-and-center legal issue for 2025. 2024 saw substantial legislative and administrative rulemaking activity at the federal and state levels. With a new administration and states continuing to consider changes, there is likely more to come on this front.

While the focus is generally on employer-worker relationships, the franchise relationship is not immune from the ongoing efforts to make enforcing noncompete covenants more difficult. Indeed, many decisions addressing noncompete covenants in franchise agreements look to case law on non-competes in varying contexts when determining whether to enforce a noncompete covenant against a franchisee or former franchisee. Thus, changes

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in existing laws and adding laws necessarily impacts noncompete covenants in franchise agreements.

Generally, the law in most states historically has been that a noncompete covenant is enforceable when it is intended to protect legitimate interests, for example, confidential information or trade secrets, and is reasonably tailored to the necessary geographic limits, duration and prohibited conduct to protect the legitimate interest. However, in recent years, multiple states have tightened the enforceability in the employment context and, generally, these state statutes only carve out minimal exceptions for the sale of the business and sometimes highly compensated individuals. Some states have even added criminal penalties for an employer's including or attempting to enforce a noncompete covenant in violation of the new law. States with recently enacted laws preventing or greatly limiting the enforcement of noncompete covenants include Colorado, Illinois, Maine, Maryland, Minnesota, New Hampshire, Oregon, Rhode Island, Virginia and Washington. Several other states are considering new legislation and some states' courts have greatly reduced the enforceability of noncompete covenants, including California, which added to its statute in 2024. Where and how a franchise agreement covenant not to compete fits into the employment-oriented noncompete law is often uncertain and unpredictable.

The FTC got involved at the federal level with a lot of activity in 2024. It published a proposed rule in the Federal Register on Jan. 19, 2023, that would have greatly limited the enforceability of non-competes in the employment context. While in the proposed rule the FTC stated that the rule was not intended to cover franchise relationships, it invited comments on whether to include franchise relationships — and in the above-referenced Report, it referenced concerns regarding noncompete covenants — and some suggested during the comment period that the rule should be expanded to cover franchisees.

Overall, the FTC received 27,000 public comments and has spent more than $500,000 and 6,000 hours on the rule. The FTC approved the new rule banning non-competes on April 23 to take effect in 120 days. However, multiple lawsuits to enjoin the rule followed, and a Texas court enjoined the rule by order on Aug. 20 in the case of *Ryan, LLC v. Federal Trade Commission*. For now, the new rule will not take effect.

In yet another development, the North American Securities Administrators Association (NASAA) just issued "guidance" on post-term non-compete provisions in franchise agreements in January 2025. That guidance statement focused on the "reasonableness" of non-competes in franchising, in which NASAA reiterated that "[p]ost-term non-competes should be narrowly drawn and reasonable in scope, duration and territory," such that the non-compete protects the franchisor's legitimate interests while sufficiently narrow to minimize harm to the former franchisee. This is in essence a recitation of the current law in most states to enforce a non-compete; but may signal a new item some state administrators will begin reviewing.

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Misclassification

Recent years have seen substantial activity in the standard applied to claims that an employer misclassified a worker as an independent contractor as opposed to an employee. If misclassified, a worker has claims to greater benefits and related claims. As the standard has changed, the question of whether a franchisee meets the definition of an employee rather than an independent contractor remains. Indeed, efforts to make the standard easier to find employment status have substantial impact on the franchise model and relationships.

Over time, at least three standards have emerged: the "economic realities test," the "ABC Test" and a two-factor test set forth during the first Trump administration for Fair Labor Standards Act (FLSA) claims, which focused on

1. The employer's degree of control over the work and;
2. The worker's opportunity for profit or loss.

In 2024, the Department of Labor (DOL) attempted to change the standard to the economic realities test for FLSA claims. The DOL published its final version of the rule on Jan. 10, effective March 11. As such, under the FLSA, the DOL employs a non-exhaustive six-factor test (the economic realities test) to determine whether an individual is classified as an employee or an independent contractor. This new rule rescinded the rule issued under the Trump administration, which never went into effect.

The Rule's Non-Exhaustive List of Factors:

- Worker's opportunity for profit or loss;
- Investments made by the worker and potential employer;
- Degree of permanence of the work relationship;
- Degree of control an employer has over the work;
- Extent to which the work performed is integral to the employer's business;
- Use of a worker's skill and initiative.

The big question is whether and, if so, when the DOL under the new Trump administration will attempt to go back to its prior proposed two-factor rule.

Meanwhile, the ABC Test remains in place in several states. This includes California, where Assembly Bill 5 went into effect Jan. 1, 2020, for determining whether a worker is an independent contractor or an employee under California employment law.

Under the ABC Test:

- A worker is an employee, not an independent contractor, unless the hiring entity can show **all** of the following:
  - The worker is free from control and direction;
  - The work is outside the usual course of the hiring entity's business;
  - The worker is engaged in an independent trade.
- A worker is presumed to be an employee, rather than an independent contractor, unless all parts of the test are met.

Recent cases suggest uncertainty will remain for some time. 7-Eleven franchisees, as well as franchisees in the cleaning industry and other lower startup-cost systems, have continued to advance claims that the franchisees are entitled to employment benefits from the franchisor. The FTC even filed an amicus brief in favor of such a claim by 7-Eleven franchisees.

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There are several takeaways for franchise relationships given this uncertainty. The new DOL test only applies to claims under the FLSA, but state-specific classification tests (like the ABC Test for California, Illinois, Massachusetts and New Jersey) are still applicable to state law claims. Thus, classification under state law might not be the same as under the DOL's new independent contractor test. Further, depending on the franchise system, some of the factors are more likely to weigh in favor of the franchisee being an independent contractor, such as the investment by the worker and the opportunity for profit or loss depending on skill. But unfortunately, some of the factors, such as whether the worker relies on training provided by the company, whether the company uses technological means to supervise the worker, whether the company prevents the worker from working for someone else and the extent that the work is integral to the company's business, could be argued to be present in almost all traditional franchise models. In light of this new test and its factors, franchisors may find they are misclassifying their franchisees as independent contractors and therefore face increased liability under the FLSA for not providing the required benefits to franchisees, such as minimum wage and overtime pay. Remedies under the FLSA include liquidated damages and attorneys' fees, as well as potential injunctive relief and civil or criminal penalties.

Joint Employer

The seesaw, or pendulum, regarding the standards for a finding of joint employment in the franchise context continued to go up and down, or back and forth, in 2024 and likely will not be settled in 2025. On Oct. 27, 2023, the National Labor Relations Board (NLRB) published its final rule revising the standard to determine whether multiple entities jointly employ certain employees under the National Labor Relations Act (NLRA). The previous test, established by rule in April 2020, required a showing of ***direct and immediate*** control over employees before an entity could be considered a joint employer. That rule was then rescinded and replaced with a new rule that would make it easier to establish joint employment. Under that proposed new standard, entities would be considered joint employers if they ***directly or indirectly share or codetermine those matters governing employees' essential terms and conditions of employment,*** such as wages, benefits, supervision and direction, work and scheduling, hiring/discharge, and workplace health and safety.

On March 8, U.S. District Judge J. Campbell Barker of the Eastern District of Texas vacated the NLRB's new rule. Judge Barker had previously stayed the joint employer rule until March 11. On May 7, the NLRB filed a notice of appeal to the Fifth U.S. Circuit Court of Appeals and Congress also passed a law to go back to the more traditional standards, but President Joe Biden vetoed that law. The NLRB has now withdrawn its appeal, so the old direct and immediate test is back for now and presumably will remain for at least the next four years under the NLRA.

The test for joint employment under the FLSA has also been shifting. In 2020, the U.S. Department of Labor (DOL) under the Trump Administration issued a rule adopting a four-factor test for joint employment under the FLSA.

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That test would have considered four factors: whether the potential joint employer

1. Hires or discharges employees;
2. Supervises or controls work schedules;
3. Sets pay rates; and
4. Maintains employment records.

This test focuses on the actual control over the relationship and is generally a higher standard to meet. Seven states and the District of Columbia filed suit against the DOL in the U.S. District Court for the Southern District of New York, asserting that the Trump-Era Rule violated the Administrative Procedure Act (APA) because it conflicted with the provisions of the FLSA. Seven months later, on September 8, 2020, the district court vacated substantial portions of the Trump-Era Rule. The Trump Administration and others appealed to the Second Circuit. In March 2021, the Biden Administration's DOL rescinded the Trump Administration's rule. The Second Circuit then dismissed for mootness.

The takeaways for joint employment include that legal standards vary by statute and court. The primary focus is "control": Does the franchisor control certain actions of the franchisee and the franchisee's employees' manner and means of how the franchisee runs its business or the essential terms and conditions of employment (hiring, firing, discipline, supervision, direction, assignments)? As noted, some courts and agencies also consider indirect control, reserved right to control and control over other aspects of the franchised business, e.g., brand standards.

Vicarious Liability Claims and Direct Liability Claims

We anticipate that claims against franchisors by both customers and employees of franchisees will remain prominent in 2025. In our experience, these claims are on the rise and have seen an increase in third-party efforts to find not only vicarious liability under theories of agency and apparent agency, but also direct liability against the franchisor under claims of negligent supervision, training or assumption of duty and similar theories. These theories of direct liability essentially claim that if a franchisor imposes certain requirements that result in bodily harm or property damages to the customer or employee, the franchisor is directly liable.

Summary of Recommended Practices To Reduce Risks of Misclassification, Joint Employment and Vicarious Liability

Regardless of theory, each of the above areas of potential liability boil down to questions of control or the right to control. As such, some recommendations follow best practices to limit claims or reduce risk of adverse findings, including:

- Clear documentation disclaiming authority to control a franchisee's employees.
- Review agreements and other documentation, including manuals and handbooks, for evidence of actual or reserved control regarding a franchisee's employees.
- Make clear that franchisees are solely responsible for all employment and personnel matters, including the hiring, firing, supervising, disciplining, scheduling, compensating and managing of their own employees.

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- Expressly disavow in writing any right to control these employment matters.
- Include that language regarding a franchisee's personnel matters or policies should be phrased as optional recommendations, when possible, that the franchisee alone may decide whether and how to implement.
- To the extent limited requirements are necessary, such requirements should be described in the context of maintaining objective operational brand standards, such as having ethical and courteous employees trained to provide a certain level of service and accommodate customer needs.
- Avoid actual or reserved control over franchisees' employment/personnel decisions.
- Franchisees should handle administrative functions regarding their employees (payroll, etc.).
- Designate third-party suppliers to provide HR services (employee screening, etc.).
- Focus interactions with franchisees' employees on brand standards.
- Do not supply mandatory employee handbooks to franchisees.
- Ensure customers and franchisees' employees know a franchisee is an independent business — signage, contracts, applications, signed acknowledgment, etc.
- Provide indemnification and insurance.
- Include an arbitration clause with a class action waiver.

Broker Registration and Disclosure

A significant issue in franchise registration and disclosure laws relates to proposals for broker registration and disclosure. This is a trend we expect to see addressed in several states and at the FTC in the coming year. As described in a separate article in this update, California amended its Franchise Investment Law, effective 2026, to add annual registration and presale disclosure requirements for franchise brokers.

In addition, as part of the FTC's current review of the Rule, many in the industry are advocating for the revised rule to include certain disclosures by third-party franchise sellers, which would include: recent professional experience; litigation history; services that the seller performs on behalf of franchisors and the compensation received; the industries and number of brands the seller represents; franchisees to whom franchises were sold during the prior calendar year; and a uniform disclosure regarding the different type of franchise sellers and some basic questions a prudent prospective franchisee may ask.

Stay tuned for more action on this front in 2025.

Corporate Transparency Act

The big news as of January 23, 2025 is that the U.S. Supreme Court lifted the injunction blocking the enforcement of the Corporate Transparency Act (CTA) (in the case of *Texas Top Cop Shop, Inc., et al., v. Garland*, No. 4:24-cv-478 (E.D. Texas, Dec. 3, 2024). Despite this ruling, reporting obligations under the CTA remain on hold due to a separate nationwide injunction issued on January 7, 2025, issued by a different federal judge in Texas in Smith et al v. United States Department of the Treasury et al., 6:24-cv-00336 (E.D. Texas, Jan. 7, 2024).

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Previously during the period when the CTA was subject to a nationwide injunction, FinCEN indicated that filings could continue to be made on a voluntary basis. We encourage reporting companies to continue their compliance efforts so as to be in a position to file should the injunction be lifted and to watch closely for updates from either courts or FinCEN – as there will be additional developments.

The CTA, if it were to go into effect in the future, would require most companies to report personal direct and indirect beneficial ownership and control information pertaining to businesses operating in the U.S. This includes personal identifying information (PII), including name, date of birth, physical home address and photograph. That PII would have to be reported for all natural persons owning, directly or indirectly, 25% or more of any class or category of economic interest in a business entity, or who have or may assert, directly or indirectly, "substantial control" over a business entity.

There are a number of issues regarding whether franchise agreements may attribute "substantial control" of a franchisee's business to the franchisor and its control persons, necessitating reporting of such franchisor person's PII on their franchisees' CTA reporting.

There are some exemptions, including certain regulated business entities, such as publicly traded companies, insurance businesses, banking businesses, 501(c) federally tax-exempt nonprofit entities, and governmental and quasi-governmental organizations, and a large operating entity exemption that applies to companies that operate from a physical commercial street address in the U.S., have 21 or more full-time U.S. employees and generate more than $5 million in annual U.S. gross receipts as reported on the business entity's prior year's federal tax filing. There is also a wholly owned subsidiaries exemption, which provides that if a parent corporation is an exempt entity and wholly owns a subsidiary entity, that subsidiary entity would also be exempt from CTA reporting.

Failure to comply created substantial liability — fines of $591 per day up to $11,820 per incident and possible jail time (up to two years) for those failing to timely and properly comply with the CTA.

What Do These Common Contractual Words Actually Mean?

Joyce Mazero
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This article focuses on reasonable efforts clauses. It is excerpted from an article co-authored by Joyce Mazero that was presented at the International Franchise Association Legal Symposium in May, which can be found here. All footnotes and citations have been removed.

Efforts Standards

Franchise agreements, like most contracts, often feature obligations expressed using "efforts" standards, such as best efforts, reasonable efforts, commercially reasonable efforts, good-faith efforts and even reasonable best efforts. Contracting parties typically use efforts standards when wanting to better ensure the completion of an action or satisfaction of a condition. An example would be ensuring that a contracting party exerts appropriate effort to achieve a goal such as satisfaction of a development quota under a development agreement or promotion of a franchise brand in a franchisee's market.

All provisions featuring efforts standards are inherently vague, as complying with an efforts obligation is a function of the circumstances. Many practitioners believe that the term "best efforts" includes the obligation to make every possible effort and to use all possible financial resources to achieve the goal. This would mean best efforts "imposes extraordinary duties of assiduity: a very high standard of care, regardless of whether the required efforts might be commercially reasonable." Bryan A. Garner, Garner's Dictionary of Legal Usage 108 (3d ed. 2011). Most practitioners treat reasonable efforts, commercially reasonable efforts and reasonable best efforts as all different from, and as imposing less of an obligation than, best efforts. There is no understanding or agreement, however, as to whether these standards are, as a practical matter, any different from each other, notwithstanding the fact that "reasonable best efforts" sounds as if it imposes more of an obligation than does "commercially reasonable efforts."

Although commentators generally accept the idea of a hierarchy of efforts standards, the case law varies depending on the jurisdiction. In the United States, courts (and drafters of the Uniform Commercial Code) have declined to recognize such a hierarchy, whereas courts in England and Canada have endorsed it.

As shown below, courts have articulated in different ways what "best efforts" means, such as:

1. Good faith, a standard grounded in honesty and fairness;
2. Something more than good faith;
3. A function of diligence;
4. General reasonableness;
5. That best efforts and reasonable efforts are the same; and
6. That commercially or all-in efforts standards are redundant.

In interpreting a good-faith efforts provision, courts are likely to use whatever standard they would use in applying the implied duty of good faith, which might require bad faith — equated with dishonesty — for breach, or it might be grounded in reasonableness.

CONTINUED ON PAGE 12

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Specific Cases

1. Best Efforts

The court in *Samica Enterprises, LLC v. Mail Boxes Etc. USA, Inc.* attempted to define best efforts as requiring a party to make such efforts as are reasonable in light of that party's ability and the means at its disposal and the other party's justifiable expectations.

Plaintiffs, as franchisees, had entered into franchise agreements to operate UPS Stores with Defendant, as franchisor. The franchise agreements contained a best efforts provision pursuant to which "[Defendant] agree[d] to use best efforts to ensure that its affiliate [UPS] gives Franchisee discounts and incentives on Franchisee's wholesale cost of UPS services." Plaintiffs alleged that Defendant failed to use best efforts in this regard.

The court considered the evidence regarding Defendants' efforts and found that the following undertakings satisfied the standard:

1. Defendant had several discussions with UPS about improving "incentives, pricing, and retail rates";
2. Defendant made "numerous requests to UPS to increase [franchisees'] margins and incentives"; and
3. Defendant suggested that UPS simplify the rate structure, providing for "incentives [on the] retail rate."

The court also noted that UPS had, itself, reserved the right to modify Plaintiffs' incentives. This fact, which limited Defendant's abilities and tempered Plaintiffs' justifiable expectations, coupled with Defendant's undisputed efforts, led the court to conclude that Defendant fulfilled its obligations.

Another example of a court grappling with the meaning of best efforts is found in *Paccar Inc. v. Elliot Wilson Capitol Trucks LLC*. The relevant franchise agreement provided that:

- DEALER shall give [Plaintiff] notice in writing before undertaking any efforts to sell the dealership…. Upon request, [Plaintiff] agrees to provide assistance to DEALER in locating BUYER candidates acceptable to both [Plaintiff] and DEALER, although DEALER shall independently negotiate any buy/sell agreement. *[Plaintiff] also agrees to make best efforts to conditionally approve potential buyers to facilitate DEALER's negotiations*. Upon conditionally approving a specific buyer, [Plaintiff] will waive its right of first refusal to that buyer.

Plaintiff here asserted that the best efforts clause was without meaning and that it could approve or disapprove of a potential buyer as it pleased. Defendant dealer disagreed.

The court analyzed the term by reviewing the context. It stated, like the court in Mail Boxes, that a best efforts standard has diligence as its essence. The court rejected Plaintiff's position and reasoned that, at the least, the best efforts provision must be interpreted to require that Plaintiff exercise some diligence in considering a potential buyer — the level of diligence to be determined by the circumstances.

The court then concluded that considering the relevant statutory background, pursuant to which consent to a transfer may not be unreasonably withheld, the necessary diligence to satisfy best efforts "must include an obligation to make reasonable efforts to approve a transfer, or conversely, to

CONTINUED ON PAGE 13

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not unreasonably reject a transfer." The court went on to reason that "reasonable efforts" implies good faith and reasonable efforts.

Based on allegations that Plaintiff consistently attempted to discourage and frustrate the transaction and informed Defendant that it would only accept a specific other buyer, the court held that Defendant had made out a claim sufficient to survive Plaintiff's motion to dismiss.

Additionally, in *Maestro West Chelsea SPE LLC v. Pradera Realty Inc.*, the parties entered into a contract for the sale of certain air rights from Defendant to Plaintiff. As part of that contract, Defendant was required to use its best efforts to obtain a waiver and subordination from JPMorgan Chase, which held the mortgage on Defendant's property. Defendant failed to obtain the waiver and Plaintiff brought this action, in part, for breach of contract based on Defendant's failure. Defendant argued that the best efforts clause was void because it contained no objective criteria or guidelines against which Defendant's efforts could be measured. The court rejected Defendant's argument, reasoning that: A court must interpret and give effect to an express best efforts clause just as it would any other contractual provision. The court repeated the well-established rules for contract interpretation: that the court is to ascertain the intention of the parties at the time they entered into the contract. And if that intent is discernible from the plain meaning of the language of the contract, there is no need to look further.

The court further provided that:

- A best efforts clause imposes an obligation to act with good faith in light of one's own capabilities. Best efforts requires that plaintiffs pursue all reasonable methods ... and whether such obligation has been fulfilled will almost invariably ... involve a question of fact. Accordingly, the precise meaning of a best efforts provision and whether the provision is breached are factual issues that cannot be resolved on the face of the complaint.

As a result, the court denied Defendant's motion to dismiss. It should, however, be noted that certain courts have also regarded the term "best efforts" with a degree of hostility because the standards applied to the term make compliance "murky."

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2. Commercially Reasonable Efforts

In *Takiedine v. 7-Eleven, Inc.*, the court noted that "the term 'commercially reasonable effort' does not have one set of definitions in this jurisdiction; rather, it is a standard of reasonableness" and that the determination of reasonableness is a factual determination based on the totality of the circumstances and includes factors such as economic interests and diligence, among others. In this matter, the court determined that Plaintiff had not presented facts to support a finding that the franchisor failed to make a commercially reasonable effort to obtain the lowest cost for products and services, as was required by the relevant franchise agreements. In large part, the franchisee's complaint was that the franchisor was not actually achieving the lowest price on certain products. The court noted that commercially reasonable effort does not require that the franchisor succeed in obtaining the lowest cost on each product.

In *Russell v. Zimmer*, an inventor sued his distributor for breach of contract, alleging the distributor, Zimmer, failed to use the required commercially reasonable efforts to sell the earnout products. The contract itself defined "commercially reasonable efforts" as:

- [T]he level of efforts, expertise and resources that it would apply in the ordinary and usual course of business to satisfaction of a comparable obligation with respect to another product or technology that is similar to the Earnout Products in terms of commercial potential, development stage and product life. This evaluation is done holistically, looking at the entire business, financial, commercial, scientific, clinical and regulatory context … including issues such as product safety and efficacy, the competitive environment, market conditions, the product's proprietary position, the extent to which health care providers would be expected to embrace the product as a desirable and competitive solution, regulatory hurdles, the product's pricing and potential profitability, and similar factors.

The 7th U.S. Circuit Court of Appeals affirmed the district court's grant of the distributor's motion to dismiss for failure to state a claim. Plaintiff alleged the distributor did not fulfill orders, terminated supplier agreements, did not maintain trademark registrations and failed to schedule internal team meetings. The court found that because Plaintiff did not plead how these failures deviated from the distributor's usual or expected standard of conduct and did not present the alleged failures in the context of the entire business, but only on a one-off basis, Plaintiff did not meet the pleading requirements to support a plausible claim that the distributor did not satisfy the standard of commercially reasonable efforts.

Conversely, *Akorn, Inc. v. Fresenius Kabi* AG provides an example of a court finding a party had failed to use commercially reasonable efforts. The court held that Plaintiff pharmaceutical company's contractual obligation to use commercially reasonable efforts to operate in the ordinary course of business meant that Plaintiff was required "to take all reasonable steps" to maintain operations in the ordinary course of business. The court found that Plaintiff failed to meet this obligation by, among other things, canceling regular audits, failing to maintain a data integrity system and not having the proper oversight in place to prevent an employee from submitting regulatory filings to the Food and Drug Administration based on fabricated data.

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Efforts Conclusion

While there is a variety of case law across multiple jurisdictions that, to varying degrees, attempts either to create or divine objective definitions of phrases such as "best efforts" and "commercially reasonable efforts," the one constant is that courts interpreting these phrases look to the context — often the accompanying language in the relevant agreement. Accordingly, it is a potentially impossible task to attempt to determine what such terms mean in a vacuum. At best, there are guidelines. However, this reality does not leave practitioners without options. What can be taken from this case law is that if these terms are to be used, one should either expressly define them or provide the conditions to be met to satisfy the standard intended.

For example, to reduce the vagueness inherent in a reasonable efforts obligation, make it an unqualified obligation of the party in question to perform in addition any tasks that are related to the desired goal and that the party does have control over. Thus, you could supplement an obligation that a franchisee uses reasonable efforts to obtain permits by requiring that by a specified date, e.g., 90 days prior to opening, the franchisee would apply for those permits.

But courts can be unrealistic in what they expect by way of guidelines for efforts provisions. For example, New York case law refers to the need for "a clear set of guidelines against which to measure a party's best efforts" to enforce such a provision. This seems to run contrary; to expect drafters to offer much in the way of guidelines for interpreting reasonable efforts provisions may undercut the point of using the term in the first place.

Trends in Mediation

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The following are two articles previously published in Forbes and highlight some of the practical challenges to obtaining the best outcome from a mediation.

Enhancing Franchisors and Franchisees' Mediation Experience by Improving on Mediators and Counsels' Execution

I recently had the pleasure of speaking on a panel at an International Franchise Association's Franchise Business Network meeting on the topic of how and why using mediation as a vehicle for resolution of franchise disputes can work. We discussed how it can work to resolve disputes for a fraction of the parties' time and costs that any arbitration or litigation proceeding would require, to provide valuable information to both sides early on about each party's claims and the opportunity to see whether the claim has real staying power when viewed through the eyes of an experienced mediator, and to preserve the business relationship or end it peacefully. Mediation can reveal and foster interest-based solutions beneficial to the parties, which arbitration and litigation never can.

Of course, mediation does not always work to achieve those ends. There are times the parties are not yet open to discussions beyond their litigation demands, and many times the claim itself has not been sufficiently framed so that a responding party can adequately respond to it. While we all understand these dynamics, I was surprised to hear stories from my co-panelists and the audience about mediation failures that had everything to do with the execution of the process by the mediator and counsel the parties selected.

Clearly, much has been written, and it is very true that the experience, emotional intelligence, situational awareness, personality, temperament and energy that any mediator gives to the mediation process is critical. And it is important that the mediator demonstrate the commitment to listening to the parties' views of the past relationship while urging them to address what a future relationship or split could look like. In this regard, a few points expressed by the panel and audience resonated with me.

First, a mediator who does not give the parties the opportunity to, at a minimum, introduce themselves, including the representatives present on behalf of both sides, seems entirely wrong-thinking. This includes cases in which either or both counsel request no joint introductory meeting. I am not a fan of opening statements or arguments at the beginning of a mediation, and I believe the parties should have made clear their claims, defenses and positions in their written statements. Rather, the introductory meeting should give both sides the opportunity to meet in person or by Zoom and "be heard" by the other side, to view the other side's demeanor, to hear their desired expectations from the process and to gauge the parties' energy and interest in the process. What I heard was that some mediators were omitting this introductory phase and separating the parties immediately. The feeling of separation can be

CONTINUED ON PAGE 17 ▸

CONTINUED FROM PAGE 16

exacerbated in a Zoom or online environment. Setting the tone and expectations of the parties for the mediation proceeding and establishing the commitment by the parties to the purpose of the proceeding is critical to the success of any mediation, and this can be greatly facilitated by a joint introductory meeting.

Second, permitting the mediation to go forward when one side has not submitted a written statement or documents to the mediator and/or the other side supporting the claim being made in the mediation and the defenses that will be asserted is not strategically smart for anyone involved. The responding party will often grow to resent a process where they feel like the claiming party is "mailing it in" by not submitting a written statement and using the mediation process as its first real opportunity to try to make its claim with the help of the mediator. The responding party who fails to submit a written statement will be seen to be demonstrating disrespect for the process, a closed mind to an agreed resolution and an insistence on moving past mediation to litigation of the dispute. Neither approach permits the mediator or the parties to bring their best to the process. While I do not think a party's entire written statement should or needs to be shared with the other side, any mediator will want to review the pertinent documents and correspondence supporting a claim, damages incurred or to be incurred, including expenses if the case goes to arbitration or trial, the parties' assessment of the strengths and weaknesses of the claim and defenses, and any resolutions being considered. If the parties' franchise agreement requires mediation prior to initiating arbitration or litigation, I suggest the provisions also state that the parties will comply with the mediation requirements of the selected mediator, which would include submission of a written statement containing the information required by the mediator.

Third, counsel's preparation and planning strategy before the mediation is critical. Pre-mediation investigation of the claims, discussions about the claims with the other side and development of a strategy for mediation are all pivotal to creating a real opportunity for a successful mediation result. While mediation is much less expensive than arbitrating or litigating the dispute, it still requires the expenditure of legal fees for attorneys and the mediator's fees, as well as time to prepare and participate in the mediation. What I heard from the panel was that, at times, counsel for the parties view the mediation process as one that is wholly the responsibility of the mediator. For the reasons stated above, nothing could be further from the truth. I recommend any franchisor or franchisee engaged in a dispute make inquiry of their respective counsel as to what counsel is doing to prepare for and optimize the mediation opportunity for the best result, including the strategy counsel intends to implement in mediation. Undertaking such pre-mediation preparation will also help set realistic client expectations of the mediation process.

Finally, the panel and audience also debated the wisdom of having a mandatory mediation provision in the franchise agreement. I think it is a good provision to include. While the parties can always agree to mediate a dispute absent a condition in the franchise agreement, the likelihood that they will agree is dependent on many variables, including one or both sides' level of anger about the dispute and/or lack of desire to compromise on any point. Having a mandatory

CONTINUED ON PAGE 18

CONTINUED FROM PAGE 17

mediation provision requires the parties to try to put the past sins of the parties in perspective and consider the feasibility of a plan for moving forward. The mandatory use of mediation as a vehicle for dispute resolution is not the problem. The problem resides in how the mediation process is executed. While mediation is certainly not exhaustive, I believe if attention is given to the points about execution of the mediation proceeding raised above, any mediation effort will be significantly enhanced.

Redirecting Anger in Mediation To Achieve Resolution: Feelings Matter

I recently conducted a mediation in which one party exhibited profound anger and pain from the beginning. The mediation involved two companies in a dispute over money and property. Both parties chose to proceed without legal counsel and were represented by their respective principals. From my initial call with each party to better understand the parties and their claims through the meetings on the day of mediation, the plaintiff's company representative referred to the other party in accusatory and inflammatory terms and sometimes made borderline racist and bigoted comments, while characterizing himself as a low-key, calm and reasonable person. He also exhibited cynicism, high confidence and a desire "to go to war" at all costs. This is not an auspicious beginning for any mediation, where trust in the process and a rational understanding of the risks of not achieving a settlement are critical.

I believed it important to understand the sources of this anger in order to redirect the settlement efforts to a fruitful conclusion, so in the initial call and early parts of the mediation session itself, I explored the basis for the anger by discussing the plaintiff's feelings about what had transpired between the parties. As I did this, I, of course, also let the plaintiff know that remarks about the defendant that were of an abusive nature would not be helpful for a successful mediation.

On several occasions during the mediation, the plaintiff lost control, continuing to use similar inflammatory language toward the defendant. I continued to try using several approaches to redirect the plaintiff's anger and behavior, including keeping the parties separated much of the time, and when together, worked on getting each side to express their feelings about the dispute and what had transpired in their business dealings. I also emphasized what the consequences of an unsuccessful mediation would be, including the cost, time and emotional drain of the trial to which they were both quickly headed.

This was an unusual experience for me as a mediator, as most parties I have encountered express themselves in less-aggressive, perhaps more "masked" terms. Largely because the defendant did not react to the plaintiff's behavior by reciprocating with equal anger and neither party wanted to endure a trial, the parties eventually reached a settlement, but the experience made me think about the place for anger in a mediation, how to use it for good and how not to allow a mediation to derail as a result of it.

While there is no place in a mediation for an abusive display of emotions by any party, anger is a normal emotion. However, in a mediation, anger has to be addressed quickly, as it is an energy-draining emotion that is contagious and can obviate the parties' ability to think clearly and make decisions. Having two very angry parties is an untenable platform for

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CONTINUED FROM PAGE 18

a successful mediation. In this case, the plaintiff's anger reflected pain — the need to satisfy unmet feelings, even in business, including the need for recognition at some level of acknowledgment and respect by the defendant for the plaintiff's position. By redirecting the discussion to what the party feels as opposed to dwelling on accusations about the other party, it was possible to expose the real needs of the angry party. This is what some call having an "I" discussion as opposed to a "you" discussion. If each party can address their anger in terms of their feelings, such as disrespect, frustration over the loss of time and money, and stress, it is more likely that the parties will see each other more authentically as human beings and acknowledge that each is suffering. It is also important to discuss with the other party what it feels like to be on the receiving end of an angry tirade and help that party understand the origins of the anger. Questions that facilitate that type of discussion include asking each party what they wished they had done differently in the business transactions and how the resulting situation was handled. Focusing on each party's feelings about the dispute can bring to a halt the attack-and-defense cycle that warring accusations can cause. Further, once the parties are able to recognize their own pain and that of the other party, it can motivate the parties to remove the pain and work toward a resolution.

Some parties may believe that they are "beneath" a discussion of feelings and will move forward only with anger. That is a challenge for any mediator seeking a resolution, as this discussion is essential in any mediation about a business relationship. Anger cannot be ignored and will require the mediator to demonstrate significant patience and a calm demeanor to get to the root of the feelings and redirect that anger to shine a light on what is at the heart of the dispute.

California Enacts New Franchise Broker Law

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On Sept. 24, 2024, California Gov. Gavin Newsom signed Senate Bill 919, the California Franchise Broker Law, into law. Officially titled the "Franchise Investment Law: Franchise Brokers," the California Franchise Broker Law amends the California Franchise Investment Law to require franchise brokers to comply with annual registration and presale disclosure requirements.

Beginning in 2026, the California Franchise Broker Law will require franchise brokers to register with the California Department of Financial Protection and Innovation (DFPI) before attempting to offer or sell a franchise in California. In this regard, the California Franchise Broker Law is similar to the existing franchise broker registration laws in New York and Washington. However, the California Franchise Broker Law goes further and imposes an additional presale disclosure obligation upon all franchise brokers. Specifically, a franchise broker may not communicate with a prospective franchisee about investing in a franchise opportunity until the franchise broker first provides the prospective franchisee with a copy of the broker's disclosure document.

Various details regarding California's new broker registration and disclosure

CONTINUED ON PAGE 20

CONTINUED FROM PAGE 19

regime remain to be sorted out, and we expect California will issue official guidance over the coming year. Below is a summary of the California Franchise Broker Law as it currently stands.

To Whom Does the California Franchise Broker Law Apply?

The California Franchise Broker Law applies to franchise brokers. It defines a "franchise broker" as "a person who directly or indirectly engages in the business of the offer or sale of a franchise, regardless of the title used by the person or any organization with which they are affiliated, and receives or is promised a fee, commission or other form of consideration from a franchisor, subfranchisor, franchisee or affiliate of a franchisor, subfranchisor or franchisee." Common titles for a franchise broker may include franchise seller, broker network, broker organization, franchise sales organization, consultant and coach.

The following are **not** considered to be a franchise broker:

- Franchisor, subfranchisor or area representative or their officers, directors or employees;
- Employee of an affiliate of a franchisor or subfranchisor;
- A franchisee of the offered franchised brand (unless the franchisee operates a franchised broker business).

The California Franchise Broker Law revises the California Franchise Investment Law to restrict who may be involved in a franchise sale. Only a person listed in Item 2 of a franchisor's Franchise Disclosure Document (FDD) that is registered in California, a licensed real estate broker or real estate salesperson, a licensed broker-dealer or agent under the California Corporate Securities Law of 1968, or a person registered as a franchise broker can be involved in a franchise sale in California.

Broker Registration Requirements

Once the California Franchise Broker Law goes into effect, it will be unlawful for a franchise broker to offer or sell any franchise in California unless the franchise broker is currently registered with the DFPI. Registration will require an annual filing. To register, a franchise broker must file copies of the following online with the commissioner of the DFPI:

- A copy of the franchise broker's Uniform Franchise Broker Disclosure Document (Broker Disclosure Document), the form of which is currently still under development;
- Payment of the applicable registration fee, currently $450 for an initial filing, $150 for a renewal filing and $50 for an amendment;
- Copies of any financial securities, insurance policies or other additional documents or exhibits required by the commissioner.

A franchise broker's registration filing is effective upon filing a complete application and paying the applicable registration fee. Registration filings will expire on Dec. 31 of the year in which they were filed.

A registered franchise broker must amend its registration with the DFPI in the event of any "material change" in the information contained in its filed Broker Disclosure Document. The requirement to amend upon a material change does not mean that the franchise broker must constantly update or revise the Broker Disclosure Document throughout the year.

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The requirement to amend is based on the same materiality standard applicable to franchisors under the California Franchise Investment Law. Also, the California Franchise Broker Law provides that the commissioner may, at some point in the future, issue a rule that further defines what is to be considered a "material change" for those purposes and the circumstances under which an amended Broker Disclosure Document must be filed.

We expect the DFPI to issue regulations over the coming year expanding the list of specific materials that must be included as part of a broker's annual registration filing, providing the required disclosure document format and clarifying what constitutes a material change that requires an amendment filing.

Broker Disclosure Document

Before communicating with a prospective franchisee about a potential franchise investment, a franchise broker must first provide the prospect with a copy of the broker's completed Broker Disclosure Document.

While the precise requirements for a Broker Disclosure Document are yet to be determined, it will include at least the following:

- A franchise broker cover page that contains standardized language regarding franchise brokers, including the types of sellers, the broker's role in the franchise sales process, services a broker might provide, different ways a broker might be compensated and examples of questions a prospective franchisee might ask a franchise broker;
- Details about the franchise broker, including legal name, trade name, year and state of formation, principal place of business, owners, directors and officers, contact information, and the franchise broker's broker network or franchise sales organization;
- The franchise broker's professional experience during the past five years, including but not limited to employers, principal positions, each position's location, and the month and year of each position's start and end dates;
- Administrative, civil or criminal actions alleging that the franchise broker, or an owner, officer or director of the franchise broker, violated any franchise, antitrust or securities law or committed fraud, unfair or deceptive practices, or similar violations, whether pending or resolved, within the past five years;
- The industries of the brands the franchise broker represents and how many brands within each industry the franchise broker represents;
- A description of the services performed by the franchise broker;
- How the franchise broker is compensated, including but not limited to how the amount of any consideration the franchise broker receives is calculated;
- Whether a broker network, broker organization or franchise sales organization may receive any additional consideration;
- The brands for which the franchise broker sold a franchise anywhere in the United States or its territories during the last calendar year for which the franchise broker received or is entitled to receive compensation, including but not limited to the total number of units sold for the brand.

CONTINUED ON PAGE 22 ▸

CONTINUED FROM PAGE 21

We expect the DFPI to issue regulations over the next year specifying the formatting and content requirements for Broker Disclosure Documents, including prescribing mandatory language for the required cover page.

Other Requirements

A registered franchise broker must keep and maintain a complete set of books, records and accounts of each California franchise offer for five calendar years after such offer.

When Must a Franchise Broker Begin Complying With the California Franchise Broker Law?

The broker registration and disclosure requirements are subject to appropriation by the California Legislature. Appropriation means, prior to the law taking effect, the Legislature must authorize the use of public funds for the purpose of carrying out the bill. The California Franchise Broker Law will go into effect on the later of July 1, 2026, or 12 months after appropriation. That is, the California Franchise Broker Law will not go into effect before July 1, 2026.

What Are the Risks if a Franchise Broker Fails To Comply With the California Franchise Broker Law?

A franchise broker who fails to comply with the California Franchise Broker Law may be liable for damages to the franchisee, subfranchisor or franchisor, as well as indemnification to the franchisor. A franchisee who worked with the broker may seek rescission of the franchise for a broker's willful violations. In addition, the commissioner may issue a stop order suspending or revoking a franchise broker's registration for violations.

Will Other States Follow Suit?

New York and Washington have long required brokers to register before offering or selling franchises. California, however, is the first state to require a broker to provide presale broker disclosures. Other states may begin to follow suit in response to the North American Securities Administrators Association's (NASAA) proposed Model Broker Registration Act.

In May, NASAA, which includes state franchise regulators, solicited public comments regarding a proposed NASAA Model Broker Registration Act (Franchise Broker Act). If adopted by NASAA, the Franchise Broker Act would be a model for states to use to regulate franchise brokers.

Similar to the California Franchise Broker Law, NASAA's Franchise Broker Act would list various prohibited practices and require franchise brokers to register with a state before offering or selling franchises, provide a presale disclosure statement to prospective franchisees and maintain specified records. The Franchise Broker Act's proposed definition of "franchise broker" is almost identical to California's new definition. NASAA reports it is preparing a draft uniform disclosure statement, which it will post for public comment once finalized.

In addition to the broker registration requirement, the Franchise Broker Act would require a franchisor to file a

CONTINUED ON PAGE 23

CONTINUED FROM PAGE 22

notice with the applicable state appointing the franchise broker before such broker may offer or sell a franchise on behalf of the franchisor. Other additional requirements of the Franchise Broker Act include:

1. A competency examination fee and exam for franchise brokers;
2. Continuing education requirements for franchise brokers;
3. Broker experience requirements; and
4. Required recordkeeping for 10 years.

For purposes of the competency exam and the continuing education requirements, a franchise broker who is not a natural person is exempt from both.

Although NASAA has not released additional information regarding the competency exam that would be required for franchise brokers, its website offers certain information about the competency exams for the other industries required by NASAA to pass a competency exam, which includes broker-dealer representatives and investment adviser representatives. For each exam, NASAA posts an outline and a study guide of the test materials. Generally, the information covered by these competency exams includes an understanding of the current applicable regulations, economic factors and business information; ethical practices and obligations; communication of prospects and customers; and the remedies available when the applicable regulations are violated.

For recordkeeping, every franchise broker must keep and maintain a complete set of books, records and accounts relating to any offers and sales of franchises, and such records are subject to examination by the applicable official of the state implementing the Franchise Broker Act. This requirement continues for a period of 10 years after the franchise broker has ceased operating as a franchise broker and would include keeping track of not only closed deals/signed franchise agreements but also records related to conversations and meetings with prospects that never resulted in a closed deal.

The public comment period regarding the Franchise Broker Act ended on June 13, and NASAA is currently reviewing all comments and considering whether to present the act, in its current or a revised form, to its board of directors for potential adoption by NASAA membership. Though NASAA's franchise-related recommendations are not binding on any state, many franchisor registration states have traditionally followed them.

We are also aware that there are efforts between NASAA and California to align the California Franchise Broker Law with NASAA's Franchise Broker Act so that there is uniformity among the states that will require franchise brokers to register and disclose candidates. We expect that NASAA may revise the proposed Franchise Broker Act and open another comment period for the revised version. This will remain an issue to watch in 2025.

Merging Franchise Systems: What To Share and What To Separate

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When a franchise system acquires or merges with another franchise system, one of the many benefits is to establish efficiencies across the portfolio and, hopefully, save time, effort and money in doing so. However, not every aspect of the franchise system can — or should — be combined.

Administratively and logistically, there are a few areas that franchisors can consider combining that likely would not cause uproar among internal staff or franchisees. First, certain third-party services, such as legal, accounting, auditing and bookkeeping services, are easily transferrable to one firm and can streamline internal processes. Also, such services do not depend on the branding or operations of the franchise systems, so combining them is likely an easier task.

Second, even if not co-branding (discussed below), it may make sense to combine marketing, advertising and promotional efforts into one service or with one provider, especially if you can cross-promote the branding message between the old and new brands. Cross-promotion allows each franchise brand to build strategic partnerships with other brands to increase awareness and increase sales, all while reducing costs in doing so.

Third, supply chain items such as inventory, supplies and equipment may be shared between the brands and, if appropriate, certain affiliates that provide such products or services can now provide them for all of the franchise brands. For example, if you have an affiliate that handles the purchasing of all espresso machines used in the operation of the franchised coffee shop and they were to acquire or merge with another coffee shop brand, then the same affiliate could then be used to provide espresso machines for all franchisees in the new, expanded system. This shared method of providing supplies not only creates efficiencies for the franchisor and its affiliates but also deepens the consistency of the customer experience at each franchise.

Last, a more complicated and extensive combination effort would be to co-brand the franchise systems. “Co-branding” means combining two (or more) distinct brands into one concept that offers a single set of products or services. The simplest of examples is seeing a Dunkin’ location combined with its sister brand, Baskin Robbins, in the same brick-and-mortar location. For many franchisors, co-branding makes sense, particularly when combining complementary or compatible brands. Benefits to co-branding may include:

- Gaining market share and expanding the customer base;
- Sharing operational functions;
- Reducing investment and operational costs;
- Leveraging the power of each brand;
- Maximizing marketing and advertising dollars;
- Increasing sales and revenue for each brand.

CONTINUED ON PAGE 25

CONTINUED FROM PAGE 24

When considering whether to co-brand, some factors to research include the market for the products/services, customer base, demand for the combined product/service, physical logistics of placing two sets of products in one location and logistics of providing two sets of services from one franchisee.

On the other hand, as great as it is to combine efforts and create new efficiencies, there are also certain aspects of the franchise system that should be kept separate, provided that the franchise systems are remaining as separate brands and separate franchise systems.

First, each franchise system should always have a dedicated management team and training team. From an optics standpoint, the franchisees need to believe that they are still being supported at least to the same extent and with the same level of care post-transaction as they were pre-transaction. Adding to the management team and/or training team is acceptable, but having one management team or training team across two different franchise systems is potentially problematic. The most obvious issue is that sharing these types of teams means that confidential information may be shared between the two teams, which takes away from the value of the brand — particularly if there are secret recipes or procedures that make one franchise system more successful. Also, sharing team members means each team member is splitting their time among a larger group of franchisees, which may exceed the team's capacity to provide adequate support.

Second, if the franchise systems operate under separate trademarks, it is important to keep financial performance information of each set of franchisees separate in the Franchise Disclosure Documents (FDDs). As with all Item 19s, the franchisor must have a "reasonable basis" for including any information in the Item 19. It would likely be unreasonable and misleading for a franchisor to present two different sets of franchisees into a combined Item 19 because a prospective franchisee buying one brand and not the other would be getting information about a brand's performance that is irrelevant. Although it is true that the Federal Trade Commission's (FTC) Franchise Rule allows for subsets of franchisees to be presented in one Item 19, the examples included in the Franchise Rule do not include different trademarks and instead include "geographic location, type of location (such as free standing vs. shopping center), degree of competition, length of time the outlets have operated, services or goods sold, services supplied by the franchisor, and whether the outlets are franchised or franchisor-owned or operated." For these reasons, it is more reasonable to keep the information in separate FDDs or, at the very least, in separate charts in the same Item 19 with clear notes that the different charts show franchisees with different brands.

Last, another item that should most likely remain separate is Item 20, which requires the disclosure of franchised and company-owned outlets in tabular form. Franchisors that offer different branded franchisees should not combine all outlets into one set of tables for Item 20. Instead, the franchisor should either (1) have completely separate FDDs or (2) have two sets of charts in a combined FDD. Prospective franchisees should be able to clearly identify the number of outlets under each brand.

Disclosure Implications When Combining Franchise Systems

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As if there wasn't already enough paperwork involved when purchasing or merging with another franchise system, there also may be disclosure obligations that are required and possibly amendment filings with the applicable registration state(s).

As a threshold matter, the mere fact that the purchase of an additional system, a merger or a change in control occurred (or, in some cases, was contemplated) may constitute a "material change" as defined by the Federal Trade Commission (FTC) in the federal Franchise Rule and, accordingly, requires a franchisor to amend its Franchise Disclosure Document (FDD). The FTC requires all franchisors to, within a reasonable time after the close of each quarter of the fiscal year, revise the FDD to "reflect any material change." "Material change" is then defined by the FTC as any change to the franchisor or in the franchise itself that is likely to have a significant financial impact on, or that is likely to influence the decision-making process of, a franchisee or prospective franchisee.

Now that the transaction is underway or has occurred, franchisors need to assess whether the purchase of the additional franchise system constitutes a material change. Unfortunately, despite the definition stated above, there is no hard-and-fast rule at the federal level about what constitutes a material change, and it is a subjective question. However, below is a non-exhaustive list of issues to review when considering the purchase of or merger with a franchise system that, depending on how the transaction answers these issues, may be considered a material change:

- Whether management from the existing franchise system will stay in place or management from the new franchise system will be incorporated;
- Whether the existing franchise system already owns other franchise systems;
- Whether the two brands will coexist and be offered as one franchise system to new prospective franchisees;
- Whether the brands will stay separate but prospects will be given the opportunity to purchase a co-branded franchise;
- The size of the existing franchise system as compared to the size of the purchased system;
- Whether there will be new affiliates that will provide products and/or services to existing franchisees;
- Whether the existing franchisees will pay fees to affiliate entities that have been added to the overall corporate structure;
- Whether the franchisor entity will survive the merger or be subsumed into a new entity;
- Whether the transaction results in additional debt and/or a reduction in the cash flow of the franchisor entity;
- Whether the transaction will cause supply chain issues or disruptions in providing products or services to existing franchisees.

CONTINUED ON PAGE 27

CONTINUED FROM PAGE 26

If it is determined that the transaction constitutes a material change, then several items of the FDD may need to be revised as a result of the transaction, including:

1. Item 1, providing names of new affiliated entities, if any;
2. Item 2, adding or removing officers, directors, franchisor managers, etc.;
3. Items 3 and 4, adding required litigation and/or bankruptcy disclosures of acquired entities and/or new Item 2 personnel;
4. Items 5 and 6, adding or revising fees that may be paid to new affiliated entities or the new franchisor entity;
5. Item 8, disclosing new affiliated entities as approved or designated suppliers;
6. Item 13, disclosing new or additional trademarks associated with the franchise system;
7. Item 19, disclosing the additional brand, if co-branding or otherwise revising to reflect the currently offered franchised businesses; and
8. Item 20, appropriately disclosing the outlets as separately branded or co-branded, as applicable, and including additional franchisees in the list of franchisees, as necessary.

In addition to the FTC's requirement to revise for a material change, several states have guidelines about what constitutes a material change and when to file an amended FDD as a response to a material change. Some states have their own definition of a material change and even provide examples.

For instance, Indiana includes the following examples of a material change:

1. Termination, closing or failure to renew either 10% of all franchises regardless of location or 10% of franchises located in Indiana;
2. Change in control, corporate name, state of incorporation or reorganization of the franchisor;
3. The introduction of a new product, service, model or line involving an additional investment by franchisees that exceeds 20% of the average investment previously made by the franchisees;
4. Any change in the franchise fees charged by the franchisor; and
5. Significant changes in the franchisees' obligations to purchase items from the franchisor, limitations on goods or services that a franchisee may offer, obligations to be performed by a franchisor or franchisee, or changes to the franchise contract or agreement or any amendments.

Maryland includes the following examples of a material change:

1. The termination, in any manner, of more than 10% of the franchises of the franchisor that are located in the state during any three-month period;
2. The termination, in any manner, of more than 5% of all franchises of the franchisor regardless of location during any three-month period;
3. Reorganization of the franchisor;
4. Change in control, corporate name or state of incorporation of the franchisor;
5. The commencement of any new product, service or model line requiring, directly or indirectly, additional investment by any franchisee; and
6. The discontinuation or modification of the marketing plan or system of any product or service of the franchisor that accounts for at least 20% of the annual gross sales of the franchisor.

CONTINUED ON PAGE 28

CONTINUED FROM PAGE 27

And New York includes the following examples of a material change:

1. The termination, closing or failure to renew, during a three-month period, of the lesser of 10 or 10% of the franchises of a franchisor, regardless of location;
2. Purchase by the franchisor in excess of 5% of its existing franchises during six consecutive months;
3. A change in the franchise fees charged by the franchisor;
4. Any significant adverse change in the business condition of the franchisor or in any of the following:
   - The obligations of the franchisee to purchase items from the franchisor or its designated sources;
   - Limitations or restrictions on the goods or services that the franchisee may offer to its customers;
   - The obligations to be performed by the franchisor;
   - The franchise contract or agreements, including amendments thereto;
   - The franchisor's accounting system resulting in a 5% or greater change in its net profit or loss in any six-month period; or the service, product or model line.

Hawaii, Minnesota and Wisconsin also have similar lists of examples. The examples provided by each are not exhaustive but can help franchisors determine whether the transaction resulted in a material change. The examples that may be triggered by a merger or acquisition are a reorganization of the franchisor, a change in control in the franchisor and/or changes in franchisees' obligations to purchase certain items from the franchisor.

In addition to having their own definitions of material change, some states have different timelines for when an amendment filing needs to be made, which are generally different than the federal requirement of quarterly, although not always. For example, in California, Maryland, Michigan, New York, North Dakota and Rhode Island, a franchisor must "promptly" file an amendment when the material change occurs; in Hawaii, Virginia and Washington, a franchisor must amend upon the occurrence of a material change; and in Indiana, Minnesota and Wisconsin, a franchisor must amend within 30 days of the material change. Illinois and South Dakota are more closely aligned to the FTC Franchise Rule and require franchisors to prepare and file amendments to the FDD after the end of each fiscal quarter to reflect any material change. Accordingly, in addition to changes to the franchise system itself, a merger or acquisition may require an amended FDD that must be filed, in a timely manner, with any and all applicable registration states.

How Franchises Have Handled Investments From Public Figures — A Review of Item 18

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Many public figures, such as celebrities, athletes and influencers, invest in and promote franchise brands.[1] Yet Item 18 is often left blank and can be perplexing to understand when a disclosure is necessary. The Federal Trade Commission's (FTC) Franchise Rule states the following:

> Item 18 of the amended Rule requires the disclosure of certain information about a public figure's involvement in the franchise system. This covers public figures who lend their name or image to the franchise, control or manage the franchisor, or invest in the franchisor.

Many celebrities and athletes have invested in a franchisor holding company's individual units or have equity-based marketing deals to promote the services or goods of a franchise. Rarely will you see a public figure involved in the day-to-day management of the franchisor. On the other hand, several public figures have launched their own franchise brands and lend their name or image to the company — often in the name of the company itself.

The FTC Franchise Rule goes on to state the following:

Use of Name, Image or Endorsement

If a public figure's name is used as part of the franchisor's name, the public figure's image is used as a symbol associated with the franchise, or the public figure endorses or recommends the franchise to prospective franchisees, then the franchisor must disclose any compensation or other benefits given or promised to the public figure. Item 18 is limited to circumstances when a public figure's identification with a system is for the purpose of selling franchises. Merely using a public figure as a spokesperson to promote a system's products or services sold to consumers does not bring a franchisor within the ambit of the amended Rule's Item 18 requirements.

Management

If a public figure is involved in the management or control of the franchisor, the franchisor must disclose the extent of that involvement, including the public figure's position in the franchisor and his or her duties in the business structure.

Investment

If a public figure invests in the franchisor, the franchisor must disclose the type and total amount of his or her investment. The "type" of investment includes cash, stock, promissory notes and any in-kind services performed or to be performed by the public figure.

1 The FTC states the following individuals qualify as a "public figure": A public figure means a person whose name or physical appearance is generally known to the public in the geographic area where the franchise will be located. Typical public figures include sports stars, actors, musicians, and similar celebrities.

CONTINUED ON PAGE 30

◂ CONTINUED FROM PAGE 29

Item 18 in 2025 and Beyond

While many public figures, whether an athlete, a celebrity or an influencer, appear in television commercials or post social media advertisements promoting products or services, this does not necessarily rise to the level needed to require disclosure in Item 18. Disclosure is required in limited circumstances, such as when a public figure's identification with a system is for the purpose of selling franchises, as stated above in the FTC Franchise Rule. If a public figure's name is in the actual brand name of the franchise, there's a pretty direct correlation between not only advertising the brand to consumers but selling the franchise to potential investors. Therefore, in that circumstance, Item 18 should be disclosed, as in the examples below.

It's rare for a public figure to have management or control of the franchisor. While a public figure may want to have some control, especially when their name or image is involved in the brand's name, day-to-day management is unlikely for two circumstances:

1. The public figure's day-to-day job that lends them to be a celebrity, such as an actor or athlete, takes up the majority of their time, and
2. Privacy, in which any public figure who has management control over the franchisor must be listed in Item 2, which in turn requires disclosure of the public figure's litigation and bankruptcy history in Items 3 and 4, which the public figure likely wants to keep as private as possible.

Therefore, a public figure may choose to invest in the franchisor instead of seeking day-to-day management control, which still may require Item 18 disclosure, but not Items 2, 3 and 4 disclosures. There's a fine line of when an investment in a franchisor requires an Item 18 disclosure, but it is typically when the services tied to the equity in the franchisor include the public figure selling and promoting the franchise to potential investors, not just the products and services of the franchise.

Multiple franchise brands with public figures have handled Item 18 differently:

1. Big Chicken

Item 18 states:

Shaquille O'Neal holds an ownership interest in (i) ABG-Shaq, LLC and (ii) SONOFBUTCHY LLC, each of which holds an ownership interest in our Parent Company. O'Neal has no direct investment in us. As one of the ultimate owners of our Parent Company, O'Neal is involved in brand development, expansion, public relations and advertising of the System. Other than benefits received in connection with his ownership interest in (i) ABG-Shaq LLC and (ii) SONOFBUTCHY LLC, O'Neal receives no compensation or other benefit from us or our Parent Company in exchange for his involvement in those activities. Except as stated above, no public figure appears in the franchise name or symbol, endorses or recommends the franchise to prospective franchisees, is involved in our actual management or control, or has invested in us.

CONTINUED ON PAGE 31 ▸

CONTINUED FROM PAGE 30

2. Wahlburgers

Item 18 states:

Mark, Donnie and Paul Wahlberg have an indirect ownership in WF's parent, WB Holding, and promote the sale of Wahlburgers franchises. As such, each of the Wahlbergs will receive an indirect financial benefit from fees paid by subfranchisees to us, some of which we remit to WF. None of the Wahlbergs have made any direct investment in us or in WF.

3. Mayweather Boxing + Fitness

Item 18 states:

Floyd Mayweather Jr., a well-known professional boxer, is a principal in our parent company, MWFH, and appears in our marketing materials and at certain public relations and marketing events. Floyd Mayweather Jr. may also make personal promotional appearances on our behalf. We can use his name and photographs in certain marketing materials promoting the Mayweather Boxing + Fitness™ name and products sold by Mayweather Boxing + Fitness™ businesses. In addition, we are permitted to use, without payment or any special charges, certain materials bearing his name and likenesses in promotional materials, provided he has no personal liability to any Mayweather Boxing + Fitness franchisee for any act or omission, regardless of whether such act or omission occurs in connection with the Mayweather Boxing + Fitness system or Marks. We may utilize Floyd Mayweather Jr. for the purpose of promoting the sale of franchises. Floyd Mayweather Jr. has a proprietary interest in us, our parent and affiliate companies.

4. F45 Training

Item 18 states:

In March 2019, Mark Wahlberg, an internationally renowned actor, executive producer and entrepreneur, invested in our ultimate parent, F45 Training Holdings Inc. (F45 Holdings). Around the same time, F45 Holdings and Mr. Wahlberg also entered into an agreement in which Mr. Wahlberg agreed to promote and participate in marketing opportunities for the F45 brand and the sale of F45 franchises in the U.S. As compensation for these services, Mr. Wahlberg was granted common stock in F45 Holdings. As of June 2024, such agreement has expired. Until June 2024, Mr. Wahlberg also served as Chief Brand Officer for F45 Holdings. Mr. Wahlberg is not involved in the management or control of the franchisor. We may in the future use Mr. Wahlberg's image and likeness from time to time for promotional purposes pursuant to agreements and understandings with Mr. Wahlberg.

In January 2021, F45 Training Incorporated and Morgan Mitchell (a renowned Australian athlete) entered into an agreement in which Ms. Mitchell has agreed to promote and participate in marketing opportunities for the F45 brand. Additionally, Ms. Mitchell will work with F45 Training Incorporated's athletics team and appear on F45TV. F45 Training Incorporated has agreed to pay Ms. Mitchell as compensation for these services.

In April 2021, F45 Training Incorporated's parent, F45 Training Holdings Inc., entered into a promotional agreement with Magic Johnson Entertainment f/s/o Earvin Johnson Jr. (a retired professional basketball player) to promote the F45 brand. As compensation, F45 Training Incorporated will pay Magic Johnson Entertainment for Mr. Johnson's services. In addition, Magic Johnson Entertainment may be

CONTINUED ON PAGE 32

CONTINUED FROM PAGE 31

eligible to receive stock in F45 Training Incorporated's parent company, F45 Training Holdings Inc.

In July 2023, F45 Training Incorporated and Noah Galloway (a former United States Army soldier and motivational speaker) entered into an agreement in which Mr. Galloway will promote and participate in marketing opportunities for the F45 brand. Additionally, Mr. Galloway will work with F45 Training's athletic team and appear on F45TV. F45 Training Incorporated has agreed to pay Mr. Galloway as compensation for these services.

Except as described above, we do not use any public figure to promote our franchise.

The Future of Public Figure Partnerships

Many public figures are launching their own companies in the franchise industry, whether it be their own stand-a-lone restaurant, gym or other concept, with the plan to franchise the business in the future. As social media has become a powerful tool to connect with consumers, fans and potential investors, public figures are leveraging their large followings to pursue their entrepreneurial endeavors. Instead of a public figure simply striking a cash marketing deal to appear in a commercial, depending on the financial backing and reach of the public figure, it may make more sense for a public figure to create their own brand or partner with a franchisor in an equity-based deal to promote the products and services of a franchisor and/or the sale of franchises.

When a franchisor partners with a public figure, there are many risks that need to be assessed. If it's a new concept that contains the public figure's name and likeness in the brand name and marketing materials, such as Mayweather Boxing + Fitness, and if hypothetically Floyd Mayweather ever got accused of a scandal or wrongdoing, it would materially harm the reputation of the brand and potentially hurt all the franchisees involved. On the other hand, when a public figure's name is not in the brand name, but they are used as a public spokesperson for the brand, and that public spokesperson gets caught in a scandal (e.g., Jared from Subway), that can also materially harm the brand's reputation.

In the new world of name, image and likeness in college sports, many franchisors have turned their marketing efforts to partnering with 18-to-22-year-old college athletes to promote the products and services of the franchisor on social media. Franchisors can reach a younger target demographic by partnering with college athletes and targeting college-aged students, who can then become lifelong customers of their brands.

Furthermore, an established franchisor that is looking to "rebrand" or spark its marketing to increase franchise sales and/or sales of its products and services may look to partner with a public figure to increase awareness of the brand. For a startup franchisor, a franchisor may seek out a public figure to bring on board, which in turn could lead to more investors and selling more units. It's important to structure these deals carefully to provide downside protection as well as make sure the public figure fulfills their obligations to promote the franchisor. As the franchise landscape gets increasingly more competitive yearly, it's important for brands to consider strategic partnerships with and investments from public figures.

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