International Franchise Association
55th Annual Legal Symposium
May 7-9, 2023

Challenges After Acquiring and Managing a New Brand

Jarina D. Duffy, Esq.
Saxton & Stump
Malvern, Pennsylvania

David J. Kaufmann, Esq.
Kaufmann Gildin & Robbins LLP
New York, New York

Melanie Parker
BELFOR Franchise Group
Nashville, Tennessee/Lansing, Michigan

TABLE OF CONTENTS

I. Introduction

So, you have purchased a franchise system to add to your portfolio of franchise brands – congratulations! Now you may be thinking, what do I do next? The goal of this paper is to help the purchaser of a franchise system navigate the next steps after the closing date of the transaction, particularly when the newly purchased franchised system is now the second, third or fourth franchise brand owned by the purchaser. This paper will provide specific guidance for how to handle potential trademark, territory, operational, logistical and legal issues that may arise after a brand is added to your portfolio.

For a bit of context, we have all witnessed the remarkable consolidation of franchisors over the past decade accomplished through mergers or acquisitions. Roark Capital Group could hold the record as the largest aggregator of franchisors, now owning Arby's; Dunkin'; Baskin Robbins; Buffalo Wild Wings; Carl's Jr.; Hardee's; Sonic; ServiceMaster; The Cheesecake Factory; and Jimmy John's (among many others). YUM! Brands, Inc., the owner of QSR stalwarts Taco Bell, Pizza Hut and KFC, two years ago acquired The Habit Burger Grill; IHG Hotels & Resorts (formerly InterContinental Hotels Group) acquired the Kimpton Hotel network, adding to its portfolio of 12 brands (including Holiday Inn, Holiday Inn Express, Crowne Plaza, InterContinental, Vignette and voco). ServiceMaster now owns Two Men and a Truck, Merry Maids, AmeriSpec Inspection Services, TruGreen Companies and Terminix (along with a number of other franchised brands). Private equity concern Trian Partners retains the controlling stake in Wendy's, which it acquired in 2007. And Restaurant Brands International acquired Popeye's Louisiana Kitchen, adding to its ownership of Burger King, Tim Hortons and Firehouse Subs.

What do these acquisitions have in common? Ostensibly very little. As noted, some were accomplished by large private equity concerns and others by large established franchisor holding companies such as YUM or IHG. Some involved the acquisition of franchise systems competing in the same sphere but at different price points (as with hotels) while others were geared to diversify investment portfolios by acquiring unrelated brands. Some of the acquisitions involved relatively small sums of money while others involve billions (indeed, sandwich chain Subway is reportedly currently putting itself up for sale for $10 billion). Even private equity acquisitions of franchisors are diverse, with private equity serving as a strategic buyer in some cases (generally a long-term investment) while others are financial buyers (acquiring a franchise system for a financial return over a relatively short period, frequently five to seven years, with the goal being to resell at a substantial gain or take the acquired network public).

However disparate all of these transactions are, they all have one thing in common: the need to manage multiple franchise systems in a way that enhances profitability and avoids business or legal pitfalls. But while the goals are common, the means of achieving them are per force as variable as the type of transactions and acquirors themselves.

It would be impossible in the space allotted to this program to fully explore each and every issue attendant to the acquisition of a franchise system. However, we shall endeavor to touch upon the most critical.

II. Expanding Vertically or Horizontally

As discussed above, some franchise systems expand by adding new lines of business and some franchise systems expand by combining a franchise system into their existing, similar franchise system.

One important factor to consider is whether you are purchasing a franchise system that is inherently a competitor of your existing franchise system. When assessing this issue, you should consider the markets served, type of business (e.g. brick-and-mortar or traveling) the types of customers, and, of course, the products or services sold to customers. If all of the above are the same or similar, then you may have acquired a competitor. And, if you have a larger existing system where the territories are fairly saturated and you have acquired a competitor that also has a large system with fairly saturated territories, then it may be more difficult to convince your existing franchisees that the additional franchise system will be beneficial to them.

An alternative approach – and a better way to head off any encroachment concerns, as discussed below – is to acquire a complementary product or service line when purchasing an additional franchise system. A complementary product or service will enhance the customer experience of your existing franchise system.

For example, BELFOR Franchise Group has expanded its home services portfolio several times over the past decade, which started with the DUCTZ and HOODZ brands, by purchasing franchise systems or existing businesses that provide complementary home services including ZPLUMBERZ, redbox+, 1-800 WATER DAMAGE, BLUE KANGAROO PACKOUTZ, Cool Binz, among others. BELFOR Franchise Group also merged with the parent company of NHance and ChemDry and, accordingly, added those brands to its growing portfolio. The BELFOR Franchise Group brands all provide a different type of home services and all franchisees operate from within a van or truck.

Other franchise system umbrellas also have a similar strategy of adding on complementary services. For example, Neighborly (which owns home service brands such as Aire Serv, Drain Doctor, Dream Doors, Five Star Painting, among others) purchased Junk King, an eco-friendly junk removal amd hauling services franchise system, and Lawn Pride, a residential lawn care franchise system, in November 2022.[i] Both of these additions expanded the home services that the overall Neighborly Brands companies provide to customers. And, similarly, in December 2022, Authority Brands (which owns home service brands such as Color World Painting, DRYmedic Restoration Services, America's Swimming Pool Company, among others) acquired The Junkluggers, an eco-friendly junk-hauling franchise system.[ii] Home service brands are not the only types of franchise systems that acquire complementary services. In February 2022, Pet

Supplies Plus, a retailer of pet supplies, acquired Wag N'Wash, a natural pet food, self-wash, and grooming franchise.[iii]

Instead of adding a complementary brand, sometimes franchise systems enlarge their customer base for the particular service by adding a similar brand. For example, Strong Youth Brands, the owner of Soccer Shots, which is a franchise system providing youth soccer programs, acquired Little Kickers, another youth soccer program franchise system.[iv] Although both brands provide the same services, Soccer Shots operates in the United States and Little Kickers operates in 25 countries other than the United States. Similarly, in May 2022, Item 9 Labs. Corp., a cannabis dispensary franchise system that operates in the United States, acquired Sessions Cannabis, a cannabis dispensary franchise system that operates in Canada.[v] Despite offering the same exact services, these brands joined forces to increase their size and customer reach in new territories. If the services are competitive, as in these cases, then avoiding territorial overlap is important in avoiding potential issues from upset franchisees. With these two examples, there is no clear territorial overlap as two merging systems operate in entirely different countries. We discuss this potential issue – encroachment – later on in this paper.

The strategy of adding complementary brands can help ease the transition of the existing franchisees who might be worried about what the transaction means for their operations and their bottom line. Or, if adding complementary brands is not the path you have chosen, then avoiding territorial overlap is a great strategy to avoid major issues with franchisees. In the next section, we discuss how to share the message within the system and to the public regarding the transaction.

III. Communications Strategy

A. General Communications Timeline

At some point during the process of the transaction, both the acquiring franchise system's management and the target franchise system's management will have to make the information public. However, it is likely not the best strategy to tell everyone at the first whisper of a potential transaction. When deciding how and when to tell everyone, first consider the general timeline of a transaction, which includes: (1) the letter of intent; (2) the purchase agreement negotiation; (3) due diligence period; (4) closing; and (5) post-closing integration.

Generally speaking, if the transaction is at a point where it would be material to a prospective franchisee, then it is time, at a minimum, to disclose the transaction in the franchise disclosure document. For example, if the existing franchise system will be acquiring a competing brand with locations that saturate all of the territories of the existing system, then a prospective franchisee would likely consider that material to its purchase of the franchise. And, if a purchase agreement has been signed, it is also likely a clear reason to disclose the transaction to prospective franchisees and possibly both internal staff and the public. We discuss this issue in more detail later in this section.

As a general theme of communication, it is in the best interest of the franchisor to communicate effectively so as to avoid being sued by its franchisees. First, it is important to keep the information relatively secret until it is clear that the transaction will proceed and close. Telling internal or external people information regarding a transaction that is still in the very early discussion phases may cause more harm than good internal staff may become unnecessarily worried about the stability of their employment and franchisees may become unnecessarily worried about the impact of the transaction on their franchised business. Unfortunately, however, there is no hard-and-fast rule about when to tell everyone and each situation is different. Some helpful points to consider are listed below:

1. How certain is it that the transaction will be finalized?
2. Will any internal staff changes be made? If so, when?
3. Will the franchisees be affected negatively by the transaction (e.g. if the acquiring brand is a competitor and will possible encroach on their territories)?
4. Will the customer base of the existing franchise system be affected by the transaction?
5. Will prices for products/services increase or decrease?
6. Will customers lose any benefits, services, loyalty/rewards accounts or anything else associated with the existing franchise brand?
7. Will the existing franchisees need to expend money to re-brand or otherwise comply with post-transaction needs?

The best strategy is to start small and slowly expand the circle of trust outward as time and certainty moves on. For example, start with high-level, senior employees internal at the existing franchise brand once the letter of intent is finalized. Then, as the purchase agreement is negotiated, additional internal personnel may need to be notified, particularly if their expertise needs to be utilized during negotiations and/or due diligence. Then, as due diligence is more underway, other personnel may need to be notified in order to undertake the research and review of the target franchise brand. When the purchase agreement is finalize, now is the time to consider disclosing the transaction in the franchise disclosure documents and also notifying existing franchisees. when doing so, make sure that the existing franchisees understand the benefits to the transaction and the potential increase in sales due to the acquisition, if applicable. When the existing franchisees learn of the transaction, the franchisor may need to make certain concessions (e.g. royalty relief, additional operational support, larger territories, etc.) in order to counteract any negative impacts to their business from the transaction. Once the franchisees (both prospective and existing) learn of the transaction, then it may be time to consider drafting and publishing a press release to let the world know of the transaction.

B. Communication with Both Sets of Franchisees

We always remind our clients engaged in acquisition activity to pay attention to the indispensable players who are not present but must at all times be prioritized – franchisees of both the franchise system acquisition target as well as those of the

acquiror's existing franchise system. They are, as we like to say, the unseen "third parties" at the table.

Franchisees, if upset by the acquisition transaction, can actually block it under certain very limited circumstances or commence costly, time consuming and divisive litigation complaining of the transaction and its effects. Long ago, when Blockbuster Video (remember them?) announced that it would be acquiring a competitor Major Video and convert all of its stores to the Blockbuster name, the transaction was stopped cold by a federal judge in Boston, Massachusetts in response to Major Video's East Coast master franchisee seeking and obtaining a preliminary injunction because his right to sell Major Video franchises would simply evaporate. The result of not anticipating and addressing such possibility in advance was that Blockbuster had to pay this master franchisee $6,000,000 to drop the suit and have the preliminary injunction vacated (that payout in today's money is worth $16,831,003.72).

This paper is neither the time nor the program to address the plethora of franchise-specific due diligence which must pertain prior to any acquisition of a franchise system. Suffice it to say, however, that such diligence must certainly and critically scrub the target franchise system's franchisee population; ascertain the politics of the franchisor-franchisee relationship and whether it is friendly or hostile; determine what franchisee rights may or will be impinged by the forthcoming transaction (and how such impingement may be avoided or alleviated); and, in general, carefully "take the temperature" of the target franchise system's franchisee population to anticipate and address likely franchisee concerns with and reactions to the forthcoming transaction.

When can or should a franchisor disclose to franchisees of the target franchise system its forthcoming acquisition? Given that state franchise registration and disclosure laws had their genesis in, and were modeled after, federal securities laws, the answer to this question is to be found in the 1988 U.S. Supreme Court's decision in *Basic Inc. v. Levinson et al.*[vi] Prior to *Basic*, no planned merger or acquisition activity had to be disclosed to shareholders until some formal instrument had been prepared and signed – a "letter of intent" or similar preliminary agreement. However, recognizing that often even the most significant merger or acquisition activity can be definitively set in motion well before any letter of intent or other preliminary agreement is executed (reportedly, the chairmen of Disney and ABC agreed to the former's acquisition of the latter in the course of a golf game), the U.S. Supreme Court in *Basic* swept away this "bright line" test for disclosure, substituting instead a following far more elastic, amorphous and inchoate standard:

> Since a merger in which it is bought out is the most important event that can occur in a small corporation's life, to wit, its death, we think that inside information, as regards a merger of this sort, can become material at an earlier stage then would be the case as regards lesser transactions (citation omitted)... Whether merger discussions in any particular case are material therefore depends on the facts. Generally, in order to assess the probability that the event will occur, a factfinder will need look to indicia of interest in

> the transaction at the highest corporate levels. Without attempting to catalogue all such possible factors, we note by way of example that board resolutions, instructions to investment bankers, and actual negotiations between principals or their intermediaries may serve as indicia of interest... **No particular event or factor short of closing the transaction need be either necessary or sufficient by itself to render merger discussions material... (M)ateriality depends on the significance the reasonable investor would place on the withheld or misrepresented information** (emphasis added).

What, then, does *Basic* require of franchisors contemplating merger or acquisition activity? While troublesome in some respects, the answer seems obvious: the subjective corporate "mindset" – as reflected by objective criteria – must be delved into per the U.S. Supreme Court. That is, talks between companies concerning possible mergers or acquisitions are routine – and routinely go nowhere. Sometimes companies will engage in discussions only to ascertain possibilities, not seriously entertaining any combination or acquisition at the present time. Sometimes, it is ego alone that drives discussions, corporate executives wanting to hear just how much their company is worth while truly having no intent to sell out or merge. Other times, corporations may feign merger or acquisition interest to satisfy shareholders and/or directors that management is truly looking to optimize shareholder value, or to deter hostile bids. In any of these circumstances, the subjective mindset of the corporation is such that no disclosure need be forthcoming, since no merger or acquisition is seriously being contemplated.

On the flipside, however, *Basic* tells us that when the urge to merge or acquire is sincere, waiting until the execution of a letter of intent or similar preliminary agreement before making a revision to the franchise disclosure document is imprudent. Many times, an agreement to merge, acquire or be acquired is reached on a handshake, with board presentations and approval, document preparation and execution, and public announcements to follow. Especially, is this so when public companies are involved, since information regarding their revenues, net worth and multiples are freely available. Thus, merger or acquisition deals have been struck with one company orally communicating to another its desire to purchase the latter for a certain multiple of EBITDA, the precise amount of EBITDA to be determined in the course of due diligence. Or, one company may orally communicate an offer to buy another at a fixed price subject to predetermined variations following the results of due diligence. In each instance, both companies' boards of directors ultimately authorize the transaction. And it is only after the determination to proceed has been made that the lawyers are told to prepare the requisite letter of intent or similar agreement.

In such circumstances, the U.S. Supreme Court's decision in *Basic* compels disclosure of the possibly forthcoming transaction as soon as each party thereto has subjectively determined to proceed with same, despite the lack of any written agreement in furtherance thereof or the possibility that, ultimately, the transaction may not proceed. Subjective determinations are difficult to ascertain but, as the Supreme Court noted in

Basic, are almost always reflected by objective criteria. We submit that certain indicia of such determinations may be relied on.

First, if a company's board of directors has determined to proceed with the negotiation and execution of a letter of intent embodying merger or acquisition terms orally agreed to, then the "subjective determination" threshold will have been crossed. Similarly, as the Supreme Court notes in *Basic*, if investment bankers are retained to carry out the transaction, even though it is not yet memorialized, then disclosure should likely be forthcoming. Moreover, per *Basic*, the size and scope of the proposed merger or acquisition transaction – and its impact on prospective and existing franchisees – needs to be taken into account (the greater the magnitude, the earlier disclosure may have to be forthcoming). Naturally, the execution of any writing memorializing the proposed transaction will trigger disclosure.

Again, it is vital for the practitioner to recall the fundamental adage of *Basic*: "No particular event or factor short of closing the transaction need be either necessary or sufficient by itself to render the merger discussions material... (M)ateriality depends on the significance the reasonable investor would place on the withheld or misrepresented information".

Synthesizing the foregoing and applying it to when an acquiror can or should communicate with franchisees of the target franchise system, it becomes clear that whether to do so depends on a business judgment that many factors influence.

Many acquirors choose not to communicate with the targeted company's franchisees until the merger or acquisition transaction is consummated. They may fear that those franchisees will try to scuttle a planned merger or acquisition. One way franchisees can do this, as indicated above, is securing preliminary injunctive relief blocking the proposed merger or acquisition. Another way is less civil but quite effective – the franchisees of the targeted chain can seek to kill the proposed merger or acquisition transaction by vociferously communicating their opposition in the press, conduct calculated to engender negative publicity sufficient to doom the transaction and/or to instill fear in those banks, brokerage houses and/or investors whose initial and ongoing financial assistance is necessary for the transaction to proceed.

Alternatively, an acquiror may want quick access to the targeted company's franchisees in an effort to gauge their forthcoming support of, or opposition to, the proposed merger or acquisition. The understanding here is simple – if too much opposition will be forthcoming from the targeted company's franchisee population, then the transaction will be reconsidered and, at times, abandoned altogether.

There is another reason that acquirors may want to communicate with franchisees of the target chain. In a competitive bidding environment, the support of franchisees in favor of one of the bidders may prove crucial to determining the outcome.

If either of the franchisors involved in a merger or acquisition scenario is a publicly held corporation, then the issue of public communication concerning the proposed transaction becomes even more complicated.

For the bodies of franchise law and securities law at times conflict regarding just what can be said – and when – regarding such a transaction. Without going into the morass of detail which attends this subject, be aware that it is possible that a publicly held franchisor's desire to disclose its business plans to existing franchisees early on may directly conflict with its duty under the federal securities laws not to disclose material non-public information in a selective fashion. And that a publicly held franchisor's duty to disclose its business plans to prospective franchisees by means of an amended franchise disclosure document may again conflict with its duty to "keep silent" during the period it is seeking to register certain securities offering documents. Alternatively, there may be an obligation under the federal securities laws to disclose a forthcoming merger or acquisition sooner than the franchisor may desire in its dealings with franchisees.

The body of securities law governing this area, and the conflicts between securities laws and franchise disclosure laws, cannot be addressed here in detail. However, be aware that skilled counsel is required to adequately navigate these waters.

Also bear in mind that if an acquiror and its target for any number of reasons desire not to disclose a planned acquisition until the very last legally required moment, both the acquiror (if it has one or more franchise systems of its own) and the target franchise system must either cease franchises sales activity (including not only new franchise sales but franchise renewal and transfers), which quite naturally is a significant problem to franchisors, or else later confront the charge that they concealed material information. Alternatively, the acquiror and the target franchise system may continue selling franchises but only if they disclose the planned acquisition activity (with the possible negative consequences identified above). The subject of how franchise disclosure documents must be updated to reflect the forthcoming transaction, and when that must take place, is discussed later in this paper.

And entities considering the acquisition of, or merger with, franchise chains should be aware of an anomaly. At times, the franchisees of those chains will be vehement supporters of the planned merger or acquisition. This response has many roots but the same salutary result for the acquiror. Indeed, after the transaction takes place, the acquiror may find the targeted network’s franchisees to be its greatest ally in reforming the acquired system to meet current competitive needs.

IV. How the Transaction Triggers Disclosure Obligations

Now that you have decided to purchase a franchise system and merge into a franchise system that you already own, there are some changes that may need to be made to your existing system’s franchise disclosure document.

First, the mere fact that the purchase of additional system, merger or 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 require a franchisor to amend its franchise disclosure document. The FTC requires all franchisors to, within a reasonable time after the close of each quarter of the fiscal year, revise the franchise disclosure document to "reflect any material change."[vii] "Material change" is then defined as any change to the franchisor or in the franchise itself that is likely to have a significant financial impact on, or which is likely to influence the decision-making process of, a franchisee or prospective franchisee.[viii]

Second, you need to assess whether the purchase of the additional franchise system constitutes a "material change." Unfortunately, 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 after the purchase of a franchise system that, depending on how the transaction answers these issues, may be considered a material change:

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

Third, several Items of the franchise disclosure document may need to be revised as a result of the transaction, including:

Item	**Applicable Disclosure Requirements[ix]**	**Possible Revisions to the Item**
1	The name and principal business address of the franchisor; any parents; and any affiliates that offer franchises in any line of business or	Chances are that new entities have been added to the overall corporate structure of the franchisor as a result of the transaction. The FTC Rule defines an

Item	Applicable Disclosure Requirements[ix]	Possible Revisions to the Item
	provide products or services to the franchisees of the franchisor. The prior business experience of the franchisor; any predecessors and any affiliates that offer franchises in any line of business or provide products or services to the franchisees of the franchisor.	"affiliate" as "an entity controlled by, controlling, or under common control with, another entity." You should assess whether the transaction added any new entities to the overall corporate structure that are now affiliates. If so, you should revise Item 1 accordingly.
2	Disclose by name and position the franchisor's directors, trustees, general partners, principal officers, and any other individuals who will have management responsibility relating to the sale or operation of franchises offered by this document.	As a result of the transaction, there may be new management personnel that will be involved in the existing franchise system. If so, then such personnel need to be added to Item 2.
3	Disclose certain litigation involving the franchisor; a predecessor; a parent or affiliate who induces franchise sales by promising to back the franchisor financially or otherwise guarantees the franchisor's performance; or an affiliate who offers franchises under the franchisor's principal trademark.	As described in Item 1, as a result of the transaction, there may be additional affiliate entities associated with the franchise system. Such affiliates may have litigation history that needs to be disclosed in Item 3.
4	Disclose certain bankruptcy information involving the franchisor; any parent; predecessor; affiliate; officer, or general partner of the franchisor, or any other individual who will have management responsibility relating to the sale or operation of franchises.	As described in Item 1, as a result of the transaction, there may be additional affiliate entities associated with the franchise system. Such affiliates may have bankruptcy history that needs to be disclosed in Item 4.
5	Disclose the initial fees and any conditions under which these fees are refundable. For this section, "initial fees" means all fees and payments, or commitments to pay, for services or goods received from the franchisor or any affiliate before the franchisee's business opens,	As described in Item 1, as a result of the transaction, there may be additional affiliate entities associated with the franchise system. And, these affiliates may be the supplier for certain pre-opening inventory, supplies, and/or services. If that is the case, then such fees need to be disclosed in Item 5.

Item	Applicable Disclosure Requirements[ix]	Possible Revisions to the Item
	whether payable in lump sum or installments.	
6	Disclose, in the following tabular form, all other fees that the franchisee must pay to the franchisor or its affiliates, or that the franchisor or its affiliates impose or collect in whole or in part for a third party.	As described in Item 1, as a result of the transaction, there may be additional affiliate entities associated with the franchise system. And, these affiliates may be the recipient of certain fees from franchisees. If that is the case, then such fees need to be disclosed in Item 6. As an example, franchisees of both systems may be required to honor each other's loyalty program and therefore pay required fees to the appropriate entity for handling such loyalty program software or hardware.
8	Disclose the franchisee's obligations to purchase or lease goods, services, supplies, fixtures, equipment, inventory, computer hardware and software, real estate, or comparable items related to establishing or operating the franchised business either from the franchisor, its designee, or suppliers approved by the franchisor, or under the franchisor's specifications. Disclose: - Whether the franchisor or its affiliates are approved suppliers or the only approved suppliers of a good or service. - Any supplier in which an officer of the franchisor owns an interest. - Whether the franchisor or its affiliates will or may derive revenue or other material consideration from required purchases or leases by franchisees.	As described in Item 1, as a result of the transaction, there may be additional affiliate entities associated with the franchise system. And, these additional affiliates may provide products and/or services to franchisees or even be the designated/sole supplier for such products and/or services. If so, Item 8 should be revised to reflect these new requirements. Similarly, the ownership of these new affiliates as suppliers (i.e. if the new officers or management own an interest in these affiliates acting as suppliers) then this additional information should be disclosed as well. Finally, if the new affiliates will derive revenue as a result of franchisee purchases, then the amount of the revenue must be disclosed in Item 8.

Item	Applicable Disclosure Requirements[ix]	Possible Revisions to the Item
12	Disclose whether the franchisor or an affiliate has used or reserves the right to use other channels of distribution, such as the Internet, catalog sales, telemarketing, or other direct marketing sales, to make sales within the franchisee's territory using the franchisor's principal trademarks. If the franchisor or an affiliate operates, franchises, or has plans to operate or franchise a business under a different trademark and that business sells or will sell goods or services similar to those the franchisee will offer.	As described in Item 1, as a result of the transaction, there may be additional affiliate entities associated with the franchise system. Such affiliates may use alternative channels of distribution or operate a similar business within the existing franchise system's franchisee's territory. If either is true, then such information needs to be included in Item 12.
13	Disclose each principal trademark to be licensed to the franchisee. For this Item, "principal trademark" means the primary trademarks, service marks, names, logos, and commercial symbols the franchisee will use to identify the franchised business. It may not include every trademark the franchisor owns.	If the two franchise systems will merge brands and operate as one or franchisees are offered the ability to co-brand their operations, then Item 13 should be revised to include the trademarks associated with the new brand.
17	Disclose the choice of law and choice of forum for dispute resolution.	If the franchisor entity has changed its location as a result of the transaction, then it may be necessary to change the jurisdiction and governing law provisions to the new location.
19	If the franchisor makes any financial performance representation to prospective franchisees, the franchisor must have a reasonable basis and written substantiation for the representation at the time the representation is made and must state the representation in the Item 19 disclosure.	If the two franchise systems will merge brands and operate as one, larger group of franchised outlets, then Item 19 will need to be revised once the merging of the brands has occurred. Prior to the merging of the brands, it is important to keep financial performance information separate.
20	Disclose, in tabular form, the total number of franchised and company-	If the two franchise systems will merge brands and operate as one or franchisees are offered the ability to co-

Item	Applicable Disclosure Requirements[ix]	Possible Revisions to the Item
	owned outlets for each of the franchisor's last three fiscal years.	brand their operations, then Item 20 needs to be updated to reflect the additional outlets. If the two franchise systems will not merge and will remain under two brands, without the opportunity to co-brand, then Item 20 likely does not need to be revised.

Fourth, 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 amendment as a response to a material change. The chart below shows the states that have their own definitions of "material change."

State	Definition
Hawaii[x]	"Material event or material change" may be determined by the director to include, but not be limited to, the following: 1. The termination, closing, or failure to renew during any three-month period of: (i) The greater of 1% or five of all franchises of a franchisor or subfranchisor regardless of location or (ii) The lesser of 15% or two of the franchises of a franchisor or subfranchisor located in this State. 2. Any change in control, corporate name or state of incorporation, or reorganization of the franchisor whether or not the franchisor or its parent, if the franchisor or subfranchisor is a subsidiary, is required to file reports under section 12 of the Securities Exchange Act of 1934. 3. The purchase by the franchisor in excess of 5% of its existing franchises during any three-month period on a continuous basis. 4. The commencement of any new product, service or model line involving, directly or indirectly, additional investment by any franchisee or the discontinuation or modification of the marketing plan or system of any product or service of the franchisor where the total sales from such product or service exceeds 20% of the gross sales of the franchisor on an annual basis
Indiana[xi]	A "material change" as defined in the statute, which includes: 1. Termination, closing, or failure to renew either: (i) 10% of all franchises regardless of location, or (ii) 10% of franchises located in Indiana; 2. Change in control, corporate name, state of incorporation, or reorganization of the franchisor;

State	Definition
	3. The introduction of new product, service, model, or line involving an additional investment by franchisees that exceeds 20% of the average investment previously made by franchisees; 4. Any change in the franchise fees charged by the franchisor; and 5. Significant changes in the franchisee's 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[xii]	"Material change", for purposes of the Maryland Franchise Law, Business Regulation Article, § 14-220, Annotated Code of Maryland, and Regulation .06 of this chapter, includes, but is not limited to: 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. A reorganization of the franchisor; 4. A 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 which accounts for at least 20% of the annual gross sales of the franchisor.
Minnesota[xiii]	A "material change" includes: 1. The termination, closing, or failure to renew by the franchisor during any consecutive three-month period after registration of ten percent of all franchises of the franchisor, regardless of location, or 10% of the franchises of the franchisor located in the state of Minnesota; 2. Any change in control, corporate name, or state of incorporation, or reorganization of the franchisor; 3. The purchase by the franchisor during any consecutive three-month period after registration of 10% of its existing franchises, regardless of location, or 10% of its existing franchises in the state of Minnesota; 4. The commencement of any new product, service, or model line involving, directly or indirectly, an additional investment in excess of 20% of the current average investment made by all franchises or the discontinuation or modification of the marketing plan or marketing system of any product or service of the

State	Definition
	franchisor where the average total sales from such product or service exceed 20% of the average gross sales of the existing franchisees on an annual basis; 5. Any change in the franchise fees charged by the franchisor; or 6. Any significant change in: (i) the obligations of the franchisee to purchase items from the franchisor or its designated sources; (ii) the limitations or restrictions on the goods or services which the franchisee may offer to a customer; (iii) the obligations to be performed by the franchisor; or (iv) the franchise contract or agreement, including all amendments thereto.
New York[xiv]	A "material change" includes: 1. The termination, closing, or failure to renew; during a three-month period, of the lesser of ten or 10% of the franchises of a franchisor, regardless of location. 2. A 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: (i) the obligations of the franchisee to purchase items from the franchisor or its designated sources; (ii) limitations or restrictions on the goods or services which the franchisee may offer to its customers; (iii) the obligations to be performed by the franchisor; (iv) the franchise contract or agreements, including amendments thereto; (v) the franchisor's accounting system resulting [in] a 5% or greater change in its net profit or loss in any six month period; or (vi) the service, product, or model line. 5. Audited financial statements of the preceding fiscal year.
Wisconsin[xv]	In Wisconsin, a "material change" includes: 1. The termination, closing or failure to renew during any three month period of (i) the greater of 1% or five of all franchises of a franchisor regardless of location or (ii) the lesser of 15% or two of the franchises of a franchisor located in the state of Wisconsin. 2. Any change in control, corporate name or state of incorporation, or reorganization of the franchisor whether or not the franchisor or its parent, if the franchisor is a subsidiary, is required to file reports under section 12 of the securities exchange act of 1934. 3. The purchase by the franchisor in excess of 5% of its existing franchises during any three-month period on a running basis. 4. The commencement of any new product service or model line involving, directly or indirectly, additional investment by any franchisee or the discontinuation or modification of the marketing plan or system of any product or service of the franchisor where

State	Definition
	the total sales from such product or service exceeds 20% of the gross sales of the franchisor on an annual basis. 5. An adverse financial development involving the franchisor or the franchisor's parent company, controlling person or guarantor of the franchisor's obligations. In this paragraph, "adverse financial development" includes, but is not limited to: (i) The filing of a petition under federal or state bankruptcy or receivership laws; or (ii) A default in payment of principal, interest, or sinking fund installment on indebtedness that exceeds 5% of total assets which is not cured within thirty days of the default.

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, (1) in California, Maryland, Michigan, New York, North Dakota, and Rhode Island, a franchisor must "promptly" file an amendment when the material change occurs[xvi]; (2) in Hawaii, Virginia and Washington, a franchisor must amend upon the occurrence of a material change[xvii]; and (3) in Indiana, Minnesota and Wisconsin, a franchisor must amend within 30 days of the material change.[xviii] Illinois and South Dakota are more closely aligned to the FTC Rule and require franchisors to prepare and file amendments to the disclosure document after the end of each fiscal quarter to reflect any material changes.[xix]

V. Franchise Agreement Provisions You Need

In addition to revising the franchise disclosure document, one other very important drafting step in the merger and acquisition context is to make sure your legal documents are flexible enough to allow for any necessary transitions and, ideally, these provisions would have been in place *prior to* the transaction. If not, then these provisions should certainly be added to the franchise agreements going forward.

First, it is important to make sure that the franchisor and any appropriate affiliate has the right to enter into the transaction in the first place. In order to provide that right, the franchise agreement should reserve the following rights for the franchisor and its affiliates:

1. *To market, offer and sell products and services that are similar to the products and services offered by the franchised business under a different trademark or trademarks at any location, within or outside the franchisee's territory.*

2. *to acquire, merge with, or otherwise affiliate with, and after that own and operate, and franchise or license others to own and operate, any business of any kind, including, without limitation, any business that offers products or services the same as or similar to the franchised business (but under different marks), within or outside the franchisee's territory.*

3. *To use the franchisor's intellectual property, trademarks and franchise system, and license others to use the intellectual property, trademarks and franchise system, to engage in any other activities not expressly prohibited in the franchise agreement.*

The above provisions allow the franchisor and its affiliates to enter into a transaction that would either add on an additional franchise system to the portfolio or merge two or more brands together.

Second, it is also important that your existing franchisees have a grant and territory provision that are both trademark specific. This way, the franchisee's rights in its territory are limited to one brand. This concept is particularly helpful if the existing franchise system and new franchise system have similar or complementary services. Without a trademark-specific grant, the franchisee could argue that the franchisor does not have the right to allow franchisees of the new franchise system to operate in the same territory as the franchised in the existing system. For example, the following language would be considered trademark specific:

The Franchise Agreement grants you the right to operate a [name of brand] franchised business only within the "Territory" defined in the Franchise Agreement.

In this same vein, the franchise agreement should have a territory provision that grants the franchisee a franchised business within a specific territory and using the franchisor's trademarks. For example:

Franchisor grants and franchisee accepts the right and obligation for the term and any renewal term (as hereafter defined):

(i) to develop and open the franchised business within the "Territory";

(ii) to adopt and use the franchise system in the operation of the franchised business; and

(iii) to adopt and use the "Intellectual Property" (including, but not limited to the franchisor's trademarks), and only in connection with the sale of food and beverage products that have been designated by Franchisor at the Shop.

Third, the franchisor should always have the right to transfer its rights and obligations under the franchise agreement to another entity without the franchisee's consent. Depending on the structure of the transaction, the existing franchisor entity may be dissolved and/or the franchise system may be under the control of a new or different entity. In order to make sure the organizational structure may be revised, the franchise agreement should include the following language:

This franchise agreement is fully transferable by franchisor and will inure to the benefit of any transferee or other legal successor to our interests herein.

Fourth, the franchisor should always have the right to change the trademarks and branding associated with the franchise system. Further, in response to such change, the

franchisees should be required to modify all branded materials at their own cost. The following language would allow for both of these important issues to be addressed:

1. *If it becomes advisable at any time in franchisor's sole discretion to modify or discontinue the use of any trademark and/or use one (1) or more additional or substitute names or trademarks, then franchisee must comply with franchisor's direction no later than ten (10) days after franchisee has received notice.*

2. *Franchisor will not be liable to franchisee for any expenses, losses, or damages franchisee sustains as the result of any such addition, modification, substitution, or discontinuance of a trademark, and franchisee must not commence or join in any litigation or other proceeding against franchisor for any such expenses, losses, or damages.*

The above clauses are necessary in the situation where the franchisor has decided to merge with another brand and change the branding of the existing franchise system. Without the above language in the franchise agreements, the franchisees could protest the change in the branding and/or demand that the franchisor pay for the costs incurred by the franchisee in changing the branding associated with their franchised business.

Lastly, the franchise agreement should allow for the franchisor to modify the products and/or services offered by the franchisees and also the franchised business itself. These types of provisions allow the franchisor, and its affiliated franchisor entities, to have the flexibility in requiring franchisees to modify the franchised business as a result of the additional products and services offered by the acquired franchise system. For example, the following language would provide for such flexibility:

1. *Franchisee acknowledges that every component of the franchise system is important to Franchisor and to the operation of the franchised business as a [NAME OF BRAND] franchise. Franchisor has the right to modify the franchise system at any time.*

2. *At Franchisor's request, Franchisee shall refurbish, up-grade, and/or remodel the franchised business, at Franchisee's expense, to conform to the building design, trade dress, and color schemes in a manner consistent with the then current image for new franchises and in accordance with any descriptions set forth in the operations manual. Such refurbishment may include, without limitation, structural changes, installation of new equipment, remodeling, redecoration, and modifications to existing improvements.*

VI. Potential Uproar from Franchisees: Encroachment

A. How to Communicate and Subside Franchisee Concerns

As discussed above, whether the acquiror communicates with the target network's franchisees before or after the transaction is consummated, effective and swift

communication with them – and with the acquiror's existing franchisees – is the order of the day.

A nationwide (and, if necessary, worldwide) series of regional franchisee conferences should be scheduled. While it may be tempting to utilize Zoom or a Microsoft Teams to conduct such conferences, experience suggests that in person meetings are preferable and demonstrate the acquiror's commitment to communicate with franchisees, answer their questions and address their concerns (difficult, but not impossible, to replicate if only web based presentations are made). If feasible, this series of nationwide/worldwide regional franchisee conferences should be scheduled in rapid succession. Hotel meeting rooms booked; franchisee travel arrangements made; and all other particulars taken care of so that meetings with all of the targeted system's franchisees, as well as the acquiror's existing franchisees (separately, of course), can quickly be held.

At such meetings, the acquiror should spend a little time introducing itself, its management team, its philosophy and its goals – with an emphasis on the words "little time." Because far more time should be devoted to addressing how the transaction will affect the "nuts and bolts" of the acquired franchised network, the existing network and the franchisees' bottom lines, hopefully in a salutary and detailed fashion. It is critical in such meetings for the acquiror of a franchisor to listen carefully to the fears, objections and concerns of franchisees – and to respond to same in a forthright manner (which response can range from dismissing the fear/complaint as unjustified to promising to swiftly rectify what is perceived by the acquiror to be a flaw in the franchise system or relationship).

The Sixth Circuit Court of Appeals perhaps put it best when addressing how post-acquisition (or pre-acquisition, depending on the circumstances) communications with franchisees should be conducted: "[I]t seems readily apparent that it is not disclosure that concerns franchisees but whether the bottom line gets better or worse after a change of ownership." See *O'Neal v. Burger Chef Systems, Inc.*[xx]

B. Market Oversaturation

Saturating the marketplace with as many points of distribution as possible to maximize retail opportunities; make procuring a company's products or services as easy, convenient and swift as possible; and, to heighten a company's name recognition and consumer awareness is a retail concept hardly restricted to franchising.

But it is this nation's mature franchisors that have perfected the art of "going where the customer is."

Consumers can purchase McDonald's hamburgers at company-owned and franchised restaurants, military bases, through delivery and even on airplanes. They eat Pizza Hut pizzas in restaurants; from "carry out" units; on the premises of other retailers (including supermarkets and department store); at various hotels; and, even in certain

school cafeterias. Travelers can often choose among multiple locations of the same brand hotel serving hub airports, such as the three Sheraton hotels situated at or near Atlanta's Hartsfield Airport.

A few business definitions are in order. "**Network expansion**" is the establishment by a company of additional retail units (such as McDonald's sit-down restaurants) within any given market or in new markets. Network expansion can include the establishment of "**non-traditional locations**", which are locations distinct from the company's traditional core retail units and include military bases; workplace cafeterias; schools; kiosks situated in malls or supermarkets or elsewhere; locations situated in theaters/stadiums/hotels/institutions; seasonal outlets (beaches, little league fields and such); core unit "satellites" or "branches"; and, outlets situated on the premises of third party retailers. "**Dual distribution**" takes place when a company establishes one or more alternative channels of distribution for its product or service, such as Haagen Dazs selling its ice cream not only in Haagen Dazs stores but in supermarkets as well. "**Market saturation**" exists when an optimal number of retail locations, either traditional or non-traditional, are established, either chain-wide or in any given market. "**Market undersaturation**" exists when the number of retail units chainwide or in any given market is insufficient to serve the consuming public's demand for products/services. Conversely, "**Market oversaturation**" takes place when too many units are established within a given market resulting in less than optimal unit revenues and profits. "**Encroachment**" refers to market oversaturation, frequently in the context of one or more franchised units suffering (or claiming to suffer) diminished revenues and/or profits as a consequence of additional company-owned or franchised units of the same brand being placed in close proximity.

In the merger and acquisition context, if following the transaction acquired brand will retain its identity and methods of doing business, there generally will be little validity to any claim of "encroachment" – the competitive landscape will remain the same as it was prior to the transaction. Nevertheless, there will still be franchisee fears of franchisor "divided loyalty" and favoritism toward one or another of the acquiror's franchise networks that must be addressed.

However, if the acquired system is "converted" to the acquiror's name, trademark and systems, the issue of encroachment can quickly arise. Put simply, brand conversion can result in a former competitor now operating under an identical name and trademark.

Which is why it is of paramount importance if a name/system change of the acquired franchise system is contemplated that, preceding the transaction, due diligence is conducted addressing post-transaction geographic proximity of all units (the acquiror's and the acquired franchise system's). Today, software can swiftly accomplish this task (thankfully supplanting the "old days" when hand drawn maps for each market had to be prepared).

When franchisors attempt to achieve market saturation through the acquisition of a competing brand and the conversion of that brand to the franchisor's name, marks and

system, they must confront and overcome the target system's franchise agreements; possible opposition and litigation predilections of existing franchisees, to whom the establishment of a new unit geographically proximate to his/her/its own to some degree may, rightly or wrongly, be viewed as a dyer threat; judicial precedent; franchise disclosure and "relationship" laws; antitrust law principles unique to franchising; and, oversight by federal and state government officials.

To existing franchisees of a mature franchise system – one which already has a number of units serving the franchisee's market – the establishment of yet another additional unit may be deemed so threatening as to prompt litigation.

Especially is this so since, as discussed below, the judiciary seems prone at times to substitute its notions of "fairness" for what the franchise agreement actually says (or strongly infers) about the franchisor's ability to establish new units.

Causes of action likely to be advanced by franchisees complaining of proximate, newly converted units following the acquisition of a competitive network include: breach of contract; breach of the implied covenant of good faith and fair dealing; common law fraud; violation of federal/state franchise laws/regulations; and, violation of federal and state antitrust laws.

With regard to the **breach of contract** cause of action one would think that the outcome is readily determinable. That is, either the contract grants territorial protection to the franchisee – perhaps blocking the establishment of a new unit within the zone of protection absent the franchisee's consent – or the subject franchise agreement affords no territorial protection at all ("site only").

But, alas, such is not the case. For as examined immediately below, even when a franchise agreement expressly states or strongly infers that no territorial protections are being conferred upon franchisees, still franchisees have argued – and the courts have sometimes agreed – that the amorphous "**implied covenant of good faith and fair dealing**" precludes the expansion activity which at first blush seems preordained by the subject franchise agreement.

Actions sounding in **common law fraud** or **violations of federal and state franchise disclosure laws** are usually fact-specific and thus easily determinable. Either the franchisor's franchise disclosure document presaged and provided for the establishment of additional units within any given territory – in which case the franchisor should prevail (unless, that is, the franchise disclosure document was somehow contravened by representations made by franchisor representatives) or it did not. If the franchise disclosure document did not – that is, was silent on the issue – then not only will common law and statutory fraud causes of action be advanced claiming "omissions of material fact," but once again the amorphous "implied covenant of good faith" will rise ascendant.

Moreover, it is usually (but not always) fairly easy to determine the outcome of **antitrust challenges** to the establishment of new units. The relevant markets, market shares, market power and other antitrust determinants are susceptible to quantification on most occasions and will rule the day in favor of the franchisor.

Unless, that is, the franchisor in question deliberately sets out to eliminate a franchisee as a retail competitor by over saturating the franchisee's market. In this regard, see *Photovest Corp. v. Fotomat*.[xxi] While the impact of *Photovest* may have been diminished in large part by subsequent judicial decisions (see, for example, *Eichman v. Fotomat Corp.*[xxii]), the antitrust theories of the *Photovest* case must still be heeded. And at all times it must be remembered that Section 1 of the Sherman Act forbids a franchisor from permitting existing franchisees to determine whether a new franchisee will be allowed to be situated proximate to those existing franchisees. Liability for engaging in such activity is well-established. See, for example, *American Motor Inns, Inc. v. Holiday Inns, Inc*.[xxiii]

C. Encroachment: The Implied Covenant of Good Faith and Fair Dealing

Given the generally predictable outcomes of the other causes of action identified above (breach of contract, fraud, antitrust), it is perhaps not surprising that most franchisee lawsuits challenging a franchisor's establishment of a franchisor's establishment of newly acquired and converted units will usually revolve around the amorphous implied covenant of good faith and fair dealing.

The implied covenant was first articulated and defined by the New York Court of Appeals in 1933 when, in the case of *Kirke La Shelle Co. v. Paul Armstrong Co.*[xxiv], the court held:

> (I)n every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing.

While the implied covenant of good faith and fair dealing originated with the judiciary, it has since been codified in Section 1-203 of the Uniform Commercial Code ("[E]very contract – imposes an obligation of good faith in its performance or enforcement") and in the *Restatement of Contracts*, Section 205. The applicability of the UCC to a franchise relationship has been addressed by the courts which, although they are divided with regard to whether the Code itself or only its principles are applicable, frequently invoke UCC "implied covenant" language regardless of which theory is selected. See, for example, *Corenswet, Inc. v. Amana Refrigeration, Inc*., 594 F.2d 129 (5th Cir. 1979) *cert. den.* 444 U.S. 938 (1979); and, *Zapatha v. Dairy Mart, Inc*., 381 Mass. 284, 408, N.E.2d 1370 (Sup. Jud. Ct. Mass. 1980).

In addition, the concept of "good faith" has been statutorily injected into many of the eighteen state franchise "relationship" laws currently on the books.[xxv] For example, the Arkansas Franchise Practices Act[xxvi] provides: "It shall be a violation of this act for any franchisor…to refuse to deal with a franchisee in a commercially reasonable manner and in good faith." Many other such state "relationship" laws similarly provide that franchisors must deal with their franchisees in good faith or, alternatively, provide that no termination or failure to renew a franchise shall be made in "bad faith".

Given the breadth of the definition of the implied covenant of good faith land fair dealing, it is not surprising that parties to a contract – including franchisees – would seek to have implied covenant notions of "fairness" supplant the express terms of their contracts. This the ostensibly law forbids. For it is well beyond cavil that the "implied covenant" can never be used to displace the express or readily inferable terms of a contract. It may only be used to augment or construe those terms. Otherwise, one party to a contract could today seek to substitute implied covenant notions of "fairness" for the very deal bargained for – and the contract reflecting that deal signed – many years ago.

Stated otherwise, the mere exercise of one's contractual rights, without more, cannot constitute a breach of the implied covenant of good faith and fair dealing, *Broad et al. v. Rockwell International Corp.*[xxvii]

The cases holding that the implied covenant may never be used to contradict the express terms of a contract; to substitute therefor implied covenant notions of "fairness"; and, that the mere exercise of express contractual rights cannot constitute a breach of the implied covenant are legion. Representative cases are: *Murphy v. American Home Prods. Corp*.;[xxviii] *Readco, Inc. v. Marine Midland Bank*;[xxix] *Teachers Ins. And Annuity Ass'n of America v. Wometco Ent. Inc.*;[xxx] *Fruitco S.A. de C.V. v. Bankers Trust Co*.;[xxxi] and, *Lui v. Park Ridge at Terryville Ass'n, Inc.*[xxxii]

In the franchise arena, too, franchisee attempts to rewrite franchise agreements based on implied covenant notions of "fairness" – when the contracts in question explicitly or inferentially address the issue at hand – were universally rejected by the counts. That is, until the 1990's cases of *Scheck, Vylene* and *Camp Creek*, all discussed below. In every other case in which a franchisee claimed that its franchisor violated the implied covenant by opening proximate units or by engaging in secondary distribution of products, the courts ruled in favor of the franchisor when the contract in question was either explicit or inferentially clear regarding what territorial rights (if any) were afforded.

In *Vicorp. Restaurant, Inc. v. Village Inn Pancake House of Albuquerque, Inc*.[xxxiii], the court had before it a franchisee complaining of its franchisor's development of a competing Village Inn in close proximity to the franchisee's unit. The subject franchise agreement provided that "… Franchisor, as owner of (its trade) name, shall and does have the right to franchise other territories, cities or areas within the State of New Mexico…". Rejecting the franchisee's claim that the franchisor breached the implied covenant of Food faith by developing its proximate unit, the court held:

> **(C)ourts have consistently rejected covenant-based franchisee encroachment claims, holding it well settled that implied covenants of good faith and fair dealing cannot be employed to nullify or contradict the express terms of a contract…**
>
> The plain meaning of … the parties' (franchise agreement) is that Plaintiff *Vicorp* may establish other Village Inn franchises in New Mexico as long as they are not placed inside (defendant's) franchised territory… Implied covenants of good faith and fair dealing do not alter that meaning… **An act contemplated by the plain language of the parties' contract cannot constitute a bad faith breach of that contract…** (emphasis added).

In 1995, yet another federal court had the opportunity to reject a franchisee's claim that its franchisor – McDonald's – violated the "implied covenant" by developing nearby units. In *Chang v. McDonald's Corp.*,[xxxiv] the subject franchise agreement made clear that no exclusive territory was being afforded to plaintiff franchisee and the McDonald's franchise disclosure document (its "Uniform Franchise Offering Circular") repeated the "site only" territorial protection afforded to the franchisee.

Rejecting the franchisee's claim that McDonald's breached the implied covenant by opening proximate units, the court held:

> (Plaintiffs) are attempting to insert an exclusive territory clause into the franchise agreement… In fact, the agreement expressly grants one location to plaintiffs and reserves, without restriction, defendants' right to operate or **franchise** other shops on such terms as defendants deem appropriate. Rather than giving any proprietary rights in other locations, the agreement rejects such rights. Rather than restricting defendants' establishment of … shops within defined geographical and chronological limits, the agreement authorizes defendant's unrestricted competition.
>
> **[P]laintiff's reasonable expectations based on the express terms of the License Agreement as well as other documents he received necessarily must have been that Defendants could establish new restaurants. The License Agreement's express provision against territorial protection of Plaintiff means that Plaintiff could not have reasonably expected protection from Defendant's expansion (emphasis in original). *Id*.**

Again, in *Cohn et al. v. Taco Bell Corporation*[xxxv], the U.S. District Court had before it a franchisee complaining of Taco Bell's alleged violation of the implied covenant due to its plan to open a unit in close proximity to one of the franchisee's units. The franchise agreement granted no exclusive territory to the franchisee. Dismissing plaintiff franchisee's implied covenant cause of action, the court held:

> A franchise agreement which permits the franchisor to open a company owned restaurant in a franchisee's restaurant trading area is certainly not

> inviting to prospective franchisees. **However, a court must enforce a contractual provision as written. A court can't redraft the agreement simply because one of the parties may have made an unwise bargain (citation omitted). …(E)xpress provisions of a contract may grant the right to engage in conduct which would otherwise have been forbidden by the implied covenant of good faith** (citation omitted) (emphasis added).

It is critical to note that, in addition to the cases cited above, in every other case in which a franchise agreement affirmatively denied territorial "exclusivity" – or limited that exclusivity – attempts by franchisees to bootstrap territorial rights by means of the implied covenant have been forcibly rejected (except for *Scheck, Vylene, Camp Creek* and *Carvel*, addressed below).

Then came along the now infamous case of *Scheck v. Burger King Corp*.[xxxvi]

Scheck stemmed from Burger King's planned opening of a restaurant on the Massachusetts Turnpike that was located two miles from plaintiff's franchised Burger King restaurant (which was just off the turnpike). The franchise agreement at issue specifically addressed the topic of territorial exclusivity in a direct way, as follows: "This license is for the described location only and does not in any way grant or imply any area, market or territorial rights proprietary to Franchisee."

On Burger King's motion for summary judgment, one would have thought the result preordained by virtue of the line of cases cited above to the effect that a court will not utilize the implied covenant of good faith to infer or imply territorial protection or exclusivity where the contract is clear that none – or only limited protection – was expressly afforded.

However, one would be wrong in this assumption. For in denying Burger King's motion for summary judgment, the U.S. District Court for the Southern District of Florida brought to bear a new and, shall we say, novel principle:

> The express denial of an exclusive territorial interest to *Scheck* does not necessarily imply a wholly different right to Burger King – the right to open other proximate franchises at will regardless of their effect on (*Scheck's*) operations. It is clear that while *Scheck* is not entitled to an exclusive territorial, he is entitled to expect that Burger King will not act to destroy the right of the franchisee to enjoy the fruits of the contract…

In other words, held the Court, Burger King had to go further then merely telling Mr. *Scheck* in his franchise agreement that he had no territorial protection whatsoever – Burger King also had to tell Mr. Scheck what any reasonable individual and all preceding and subsequent courts (at least until *Camp Creek*, *infra*.) would immediately and logically conclude: that Burger King could open restaurants anywhere it pleased.

Burger King thereafter settled with Mr. Scheck by paying him hundreds of thousands of dollars.

It appeared that the "logic" of *Scheck* was short lived. For in *Burger King Corp. v. Weaver et al.*,[xxxvii] the very court which decided *Scheck* swiftly repudiated it.

In *Weaver*, the Court had before it the same factual setting, contract and legal issues as it did in *Scheck*: a Burger King Franchisee complaining that Burger King breached the implied covenant by placing a new restaurant in proximate vicinity to the franchisee's Burger King's restaurant. Granting Burger King's motion for summary judgment, the U.S. District Court for the Southern District of Florida utterly repudiated the logic of *Scheck*, instead holding:

> (A) claim for breach of the implied covenant of good faith and fair dealing cannot be maintained under Florida law absent an allegation that an express term of the contract has been breached. Weaver has not and cannot claim breach of any express contractual provision in this case.

And to drive home the point that the very court which rendered *Scheck* was now repudiating it, the Court observed: "To the extent that our decision today may conflict with *Scheck*, we find that it read Florida law more expansively then is warranted by the case law".

If any doubt remained at the time that *Scheck* was an aberrational blot that had been rectified by the very court responsible for it, then *Barnes v. Burger King Corporation*,[xxxviii] seemingly removed all doubt. In *Barnes*, we again encounter the same Burger King franchise agreement terms; the same "implied covenant" claim by a Burger King franchisee complaining of another restaurant opening in close proximity to his; and, the same result as pertained in *Weaver* – that is, the Court once again rejecting the franchisee's "implied covenant" claim and granting summary judgment to Burger King, as follows:

> The application of the covenant of good faith… is not without limits… The implied covenant of good faith should not be invoked to override the express terms of the agreement between the parties… Burger King was entitled to open an additional Burger King franchises in the vicinity of Barnes' franchise. This finding is based upon the express language of the Franchise Agreement, which explicitly states that Barnes is not entitled to any territorial or area rights and which in way provides that Burger King is not entitled to open additional franchises in the vicinity of Barnes' franchise. **(T)his court will not enforce an implied covenant of good faith and fair dealing in the Franchise Agreement where doing so would contravene the express terms of the agreement**… (emphasis added).

Since *Scheck*, and until *Carvel* and *Camp Creek* (addressed below), only one other decision nationwide has ever permitted a franchisee to advance an "implied covenant"

cause of action in contravention of the express terms of the subject franchise agreement – *Vylene Enterprises, Inc. v. Naugles, Inc. et al*.[xxxix]

But, in fact, the Ninth Circuit Court of Appeals decided *Vylene* relying on *Scheck* – wholly unaware that *Scheck* had been repudiated repeatedly by the very court which rendered that decision (all briefs to the Ninth Circuit except for *Vylene's* final brief were submitted prior to the *Scheck*-repudiating decisions cited and discussed above). Further, the franchisor in *Vylene* engaged in a series of what the court termed "bad acts" which may further have influenced the Court's decision (among other things, a male executive of the franchisor, following the end of an affair with a female principal of the franchisee, allegedly had the franchisor engage in certain actions which proved deleterious to the franchisee).

But later that same year, the Ninth Circuit seemed to repudiate *Vylene* in *Chang v. McDonald's Corp*.[xl] In *Chang*, a McDonald's franchisee complained that McDonald's opening of a new restaurant in close vicinity to the franchisee's constituted a violation of the implied covenant. In considering an appeal of the District Court's grant of summary judgment to McDonald's, the Ninth Circuit rejected franchisee Chang's "implied covenant" argument and affirmed the lower court decision as follows:

> Chang…argues that McDonald's conduct breached an implied covenant of good faith and fair dealing. He relies principally on *Scheck v. Burger King Corp*. (citation omitted)… We conclude, however, that the express agreement between these parties' controls what expectations are reasonable…The contract thus negates an inference that McDonald's actions were so far outside the parties' reasonable expectations as to constitute a breach of the implied covenant.

And in another case decided just thereafter, *Payne et al v McDonald's Corp*.[xli] the U.S. District Court for the District of Maryland further repudiated *Scheck*. In *Payne*, a McDonald's franchisee claimed that the company's opening of a restaurant in close vicinity to his violated the implied covenant. McDonald's motion to dismiss was granted and the court went to great lengths to note that, in its view, *Scheck* was no longer good law, as follows:

> …(T)he *Scheck* decisions have been consistently disavowed by other judges of the Southern District of Florida (citing *Barnes v. Burger King Corp*. and *Burger King Corp. v. Weaver, supra*.)
>
> Certainly, in view of these later decisions of other judges of the Southern District of Florida, the *Scheck* rulings cannot be viewed as retaining any vitality (emphasis added).
>
> …(P)laintiffs' reliance on (*Vylene*) is misplaced… *Vylene* relied on *Scheck* which, as discussed herein, has now been disavowed by other judges of the Southern District of Florida.

Thus had *Scheck* been relegated to the dustbin of ill-advised judicial decisions – until, that is, the Eleventh Circuit Court of Appeals rendered its decision in *Camp Creek Hospitality Inns, Inc. d/b/a Sheraton Inn Atlanta Airport v. Sheraton Franchise Corporation et al*.[xlii]

In *Camp Creek*, the franchisee-plaintiff operated a Sheraton Inn proximate to the Atlanta airport. *Camp Creek* was not the only Sheraton property close to the Atlanta airport when the franchise agreement was signed – the Sheraton Hotel Atlanta Airport, another franchise, already served that vicinity. In March of 1992, Sheraton began to consider acquiring another hotel property in the vicinity of the Atlanta Airport, then operating under the Hyatt flag, and the Camp Creek franchisee brought suit complaining *inter alia* breach of the implied covenant of good faith and fair dealing arising from Sheraton's alleged encroachment. (A number of other wrongs were alleged in the complaint which are not germane to the topic addressed herein.)

The Eleventh Circuit noted that the subject Sheraton license agreement contained no grant of territorial exclusivity to *Camp Creek* but was "site only" in nature. However, the Eleventh Circuit for some reason ascribed great importance to contractual language which specifically reserved to Sheraton the right to license additional hotels, while silent on Sheraton's ability to itself acquire and operate competing hotels:

> (The franchise agreement) language makes it clear that Camp Creek had no contractual right to expect the Sheraton (sic) to refrain from licensing the Sheraton name to additional franchises beyond the site of (Plaintiff's) Inn… By the express terms of the contract, therefore, the Sheraton (sic) could have authorized a competing franchise directly across the street from the Inn, and Camp Creek would have little recourse…
>
> Sheraton, however, did not establish such a franchise in this case; instead, it purchased and operated the (additional Sheraton hotel) on its own behalf. Although the standard form license agreement Sheraton used in its negotiations with *Camp Creek* contains language addressing Sheraton's ability to compete with a franchisee, the parties deleted that language from their contract. Although the parties contest the reason for the deletion, the fact remains that the fully integrated License Agreement is not ambiguous; it is simply silent on the issue of whether or where Sheraton and its affiliates can establish properties that compete with the (franchisee's hotel). Sheraton's argument that the site-only term dictates the outcome of this case, therefore, is unavailing.

The Eleventh Circuit then amazingly referred to and relied upon the outdated, repudiated and judicially maligned *Scheck* decision in denying Sheraton's motion for summary judgment. No, held the Court, it is not enough for a franchisor to tell its franchisee that it will enjoy absolutely no territorial exclusivity or protection whatsoever. Instead, the franchisor also has to specifically tell the franchisee that which any reasonable person would understand – that the franchisor, either itself or through other franchisees, could open units in close proximity. Fascinatingly, the Eleventh Circuit, in

deciding as it did, identifies as the "seminal case" in this area not any of the landmark cases stretching back for well over a decade described in this paper (they are not cited, addressed, distinguished, reversed or even mentioned) but the near-catatonic *Scheck* case – which even the Eleventh Circuit itself characterized in *Camp Creek* as "criticized, ignored and distinguished in a number of subsequent opinions."

The late 1990's suggested a return to rationality concerning the implied covenant of good faith and fair dealing.

In *Davis et al. v. McDonald's Corporation*,[xliii] (applying Illinois law), a five unit McDonald's franchisee, complaining of McDonald's establishment of new units in his markets, commenced an action charging McDonald's *inter alia* with breach of contract and breach of the implied covenant of good faith and fair dealing. McDonald's moved for summary judgment of these actions, and the court granted same. Conspicuously absent from the court's decision was any reference to *Scheck, Vylene* or *Camp Creek*. Instead, the court held:

> …(T)he Court finds that the franchise agreements constitute the complete and exclusive expressions of the parties' contracts with respect to the franchises… (Plaintiff) has not produced any evidence…which would suggest that the parties did not intend for the franchise agreements to be complete and exclusive expressions of the contracts.[xliv]

Critically, the court held that plaintiff-franchisee in this action could not incorporate by reference into his McDonald's internal expansion guidelines protocol.

But the court, even in denying relief to the franchisee in this case, rendered dicta which may prove helpful to other franchisees in future actions, as follows:

> This Court can imagine a situation where a franchisor's development of a restaurant next door to an existing franchise might so completely frustrate the purpose of the franchise agreement and deprive the existing franchisee of the fruits of the agreement that an action for breach of contract would exist. That, however, is not the situation confronting this Court. Without alleging how profitable his franchises remained after the development of additional restaurants in the (market) area, (Plaintiff-franchisee) merely contends that his sales were significantly impacted.[xlv]

The court in *Davis* also proclaimed what to franchisors is an obvious truth:

> As a practical matter, this Court has difficulty foreseeing a situation where a franchisor might develop a new store next to an existing franchise. The franchisor has every interests in maintaining sufficient distance between stores so as to sustain a healthy level of profits at all locations and thereby render the locations suitable for the franchisor's own operation or capable of attracting franchisees.[xlvi]

In 1999, the Eleventh Circuit Court of Appeals in *Burger King Corporation v. Weaver*[xlvii] appeared to once and for all have struck the death blow to the mischievous – and much maligned – 1991 decision in *Scheck v. Burger King Corporation*.[xlviii] Just a year and a half after its decision in *Camp Creek*, addressed above, the Eleventh Circuit Court of Appeals did a complete turnaround in *Weaver*. At the District Court, Burger King's motion for summary judgment on Weaver's claims of breach of the implied covenant of good faith was granted. On appeal, the Eleventh Circuit went even further, affirming the District Court's decision and sounding the death knell for *Scheck*:

> The reasoning of *Scheck*… is also unconvincing logically. The *Scheck* court held that the franchisee had a cause of action, even though the franchise agreement provided no right to exclusive territory, because BKC (Burger King Corporation) had not expressly reserved the right to license additional Burger King restaurants nearby. The flaw in this reasoning is that right and duty are different sides of the same coin; if one party to a contract has no right to exclusive territory, the other party has no duty to limit licensing of new restaurants (emphasis in original).
>
> The right and duties of the parties to a franchise agreement are created by the agreement. In the absent of an agreement, neither party has a duty to perform and neither has a right against the other. Thus, in this case, if Weaver's franchise agreement did not grant him a right to an exclusive territory, BKC incurred no duty to refrain from licensing new franchises in the area. It is undisputed that Weaver's franchise agreements did not grant *Weaver* the right to an exclusive territory. Therefore, BKC had no duty to refrain from licensing new franchises… The *Scheck* court's attempt to separate the franchisee's right from the franchisor's duty is logically unsound.
>
> In the present case, the district court correctly concluded that Weaver's claim for breach of the implied covenant must fail as a matter of law, because *Weaver* cited no express provision of either franchise agreement that had been breached. Under Florida law, Weaver's failure to identify an express contractual provision that has been breached dooms his claim for breach of the implied covenant of good faith and fair dealing.

Most courts determining encroachment claims since *Weaver* have followed its lead by holding that the implied covenant of good faith and fair dealing can never upset the express terms of a franchise agreements. But the implied covenant rose from the dead yet again five years ago in *Bryman v. El Pollo Loco, Inc.*[xlix] in which a franchisee – whose franchise agreement afforded no territorial exclusivity whatsoever – claimed that its franchisor breached the implied covenant by establishing two company-owned restaurants in proximity to the franchisee's restaurant. The jury in *Bryman* awarded the franchisee $8.8 million, specifically invoking the franchisor's purported breach of the covenant of good faith and fair dealing in doing so.

So it is that the amorphous implied covenant of good faith and fair dealing, though rarely successfully invoked by franchisees, nevertheless is still invoked by courts from time to time in a fashion that seemingly substitutes the judiciary's notions of fairness for what the subject franchise agreement actually says and the expectations of the parties actually were.

D. Litigation Avoidance: Ameliorating Franchisee Concerns over Newly Acquired and "Converted" Franchise Units

Franchisee concerns over the establishment of newly acquired and converted units within the franchisee's market – which, if left unaddressed, can prompt great fear and result in litigation – may often be addressed and ameliorated such that the franchisee no longer feels threatened and the franchisor-franchisee relationship remains intact, rather than frayed.

Indeed, many franchisors have established network expansion protocols to accomplish these goals. Under these protocols, some or all of the studies, communications and ameliorative measures suggested immediately below are engaged in before or contemporaneously with a franchisor's decision to establish a new unit within an already occupied market.

Naturally, the single greatest fear of the affected franchisee is that its revenues or net profits will be negatively impacted by the new unit(s) in question.

Accordingly, harsh resistance from all affected franchisees may be forthcoming – unless it can be shown that, in some fashion, the existing franchisees' income, while perhaps subject to a temporary downturn, will ultimately be favorably influenced as a result of the establishment of the additional unit(s). Franchisees often do not realize that, while new units in their markets may result in a "dip" in gross sales for a limited period of time, typically such gross sales will subsequently rise well above preexisting levels due to the increased market presence facilitated by the new unit(s) and concomitant increase name recognition, local advertising expenditures and interbrand competition.

Accordingly, when franchise agreements may preclude the introduction of newly acquired and converted units into the affected market and/or such activity will generate hostility and litigation, it is frequently wise to conduct and disseminate market research studies and "impact" analyses to quell franchisee anxiety. The positive economic forecasts revealed in such studies may go a long way toward calming franchisee fears. And the goodwill of the franchisor commissioning and disseminating such studies before engaging in market expansion does not go unnoticed. (Again, many mature franchisors include the preparation and dissemination of such "impact" studies as part of their network expansion protocols.)

If the subject franchise agreement(s) expressly prohibits the introduction of a new unit into the market, or if litigation complaining thereof will otherwise be forthcoming, and if the requisite market research and other "impact" studies do not support the proposition

that affected franchisee revenues and profits will not be negatively impacted (or will be negatively impacted only for a brief period of time, following which they will be restored or may even supersede earlier levels), then the following economic inducements (without limitation) may be considered to procure franchisee waiver of any claims arising from or related the proposed market expansion activity:

1. Offer the affected franchisee(s) a "right of first refusal" to establish new units in the subject market.
2. Offer to have the franchisor engage in a supplemental advertising program in the affected market at the franchisor's expense.
3. Reduce or temporarily suspend affected franchisee advertising fund contributions, with the franchisor to make up the difference.
4. Reduce, either temporarily or for the balance of the term of the franchise(s), the continuing royalties payable by the affected franchisee(s) (or eliminate them entirely for an extremely limited period of time). Any diminished royalty payments must be pegged to a "sliding scale" keyed to the existing franchisee's revenue loss and his/her ability to demonstrate that the new unit(s) in question **actually** was proximately responsible for a demonstrable diminution of franchisee gross revenues; that the new unit(s) was the **sole or primary** cause of the revenue decline; and, that the diminution of franchisee gross revenues was sustained over a minimum period before a franchisee claim for royalty reduction may be forthcoming.
5. Some franchisors have even offered to pay actual damages – but nothing else (such as punitive damages or attorney's fees) – to negatively impacted franchisees who elect to follow an in-house arbitration procedure to recover same. In this fashion, the affected franchisee does not have to prove that the franchisor's territorial expansion activity was legally prohibited. All the franchisee has to do is establish a substantial (beyond a certain percentage) decline in gross revenues that was demonstrably caused by the new unit(s) in a direct and proximate fashion. The franchisor in such circumstances benefits by avoiding litigation and limiting its payment of damages (which, in the litigation setting, could be vastly bloated by punitive damages, attorney's fees and, in certain circumstances, treble damage awards).
6. Award the affected franchisee(s) the right to establish additional units (or branch, satellite or kiosk locations) at other sites within the market as compensation for any diminution of revenues proximately caused by the establishment of the new unit(s) in question.
7. When there is no other feasible solution – such as when newly acquired and "converted" units are situated right across the street from an existing franchised unit – the acquisition of the existing unit or the acquired "converted" unit (depending on which is more profitable) may be considered.

We are pleased to observe that, while lawsuits arising from franchisee claims of encroachment continue to be filed, there has concomitantly been an increasing awareness among franchisors and franchisees alike that creative solutions to market expansion issues, and even collaboration on such matters (to the extent antitrust law

permits), is preferable to the expense and frayed relationships fostered by franchisor-franchisee litigation.

VII. What to Share between the Franchise Systems

The purchase of an additional franchise system may be an opportunity to combine certain operational tasks and create efficiencies throughout the new, expanded franchise system.

The first idea may be to co-brand the two franchise systems. "Co-branding" means combining the two, distinct brands into one concept that offers a single set of products or services.[i] The simplest of examples is seeing a Dunkin Donuts 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[ii] to co-branding include:

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

When considering whether to co-brand, some factors to research include the market for the products/services, customer base, demand for 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.

Second, even if not co-branding, certain third-party services like legal services, accounting services, auditing services, 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 they are an easy task to combine.

Third, even if not co-branding, it may make sense to combine marketing, advertising and promotional efforts into one service, especially if you can cross-promote the branding message. Cross-promotion allows each franchise brand to build strategic partnerships with other brands to increase awareness and increase sales, all while reducing costs to do so.

Fourth, 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 (as is the case for Cali Coffee Franchising), 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.

VIII. What to Keep Separated

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 as 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 as 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 potential 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 the franchise system 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, then it is important to keep financial performance information of each set of franchisees separate in the franchise disclosure documents. As with all Item 19s, the franchisor must have a "reasonable basis" for including any information in the Item 19.[lii] 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 FTC Rule allows for subsets of franchisees to be presented in one Item 19,[liii] the examples included in the FTC 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."[liv] For these reasons, it is more reasonable to keep the information in separate franchise disclosure documents or, at the very least, in sperate charts in the same Item 19 with clear notes that the different charts show franchisees with different brands.

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

IX. Conclusion

By conducting the appropriate due diligence – both in the research regarding the target franchise system and in preparing the existing franchise system's legal documents – a transaction involving the addition of another franchise brand can be a benefit to all parties, including both sets of franchisees. Despite potential issues such as encroachment and franchise amendment filings, merging with or acquiring another brand may be the best avenue for expanding a brand's customer reach. The decision to follow through with such a transaction should not be taken lightly and effective communication can (and should) be used to eradicate and internal personnel or franchisee concerns.

End Notes

[i] https://www.neighborlybrands.com/press-center/news/2022/neighborly-acquires-junk-king-the-nation-s-top-r/

[ii] https://www.prnewswire.com/news-releases/authority-brands-acquires-the-junkluggers-301705319.html

[iii] https://www.prnewswire.com/news-releases/pet-supplies-plus-acquires-wag-n-wash-natural-pet-food--grooming-301488399.html

[iv] https://www.businesswire.com/news/home/20221030005034/en/Stronger-Youth-Brands-Acquires-Little-Kickers

[v] https://www.franchisewire.com/item-9-labs-corp-to-acquire-43-store-sessions-cannabis/

[vi] 485 U.S. 224, 108, S.Ct. 978, 99 L.Ed. 2d 194 (1988).

[vii] 16 C.F.R. § 436.7(b).

[viii] 16 C.F.R. § 436.7(d).

[ix] 16 C.F.R. § 436.5.

[x] Haw. Code, Regulations § 16-31-1.

[xi] I.C. § 23-2-2.5-13.1(b).

[xii] Md. Code Regs. § 02.02.08.01.

[xiii] Minn. Code Regs. § 2860.2400.

[xiv] N.Y. Gen. Bus. Laws. Regs. §200.5.

[xv] Wis. Admin. Code s. DFI-Sec. 31.01(2)(a)-(e).

[xvi] Cal. Corp. Code § 31123; Md. Code Ann., Bus. Reg. §14-220; Mich. Comp. Laws §445.1519; N.Y. Gen. Bus. Law § 683.9; N. Dak. Cent. Code §51-19-07(6); R.I. Gen. Laws §19-28.1-11.

[xvii] Hi. Rev. Stat. § 482E-3(b); 21 Va. Admin. Code §5-110-40; Wash. Rev. Code §19.100.070(3).

[xviii] I.C. § 23-2-2.5-13.1(a); Minn. Stat. § 80.C.07; Wisc. Code § 553.31.

[xix] 815 Ill. Comp. Stat. 705/11; Ill. Admin. Code tit. 14, §200.604; S. Dak. Code §37-5B-7.

[xx] 860 F.2d 1341 (6th Cir. 1988).

[xxi] 606 F.2d 704 (7th Cir. 1979, *cert.* denied 445 U.S. 917, 100 S.Ct. 1278, 63 L.Ed. 601 (1980).

[xxii] 880 F.2d 149 (9th Cir. 1989).

[xxiii] 551 F.2d 1230 (3rd Cir. 1975).

[xxiv] 263 N.Y. 79, 87, 188 N.E. 163, 167 (1933).

[xxv] Arkansas Franchise Practices Act, Arkansas Code Ann., Title 4, Ch. 72, Section 4-72-201 *et seq.*; California Franchise Relations Act, California Business and Processions Code, Div. 8, Ch. 5.5, Section 2000 *et seq.;* Connecticut General Statutes, Title 42, Ch. 739 Section 42-133e *et seq.;* Delaware Franchise Security Law, Delaware Code Ann, Title 6, Ch. 25, Section *et seq.;* Hawaii Rev. Stat., Title 26, Ch. 482E, Section 482-E6; Illinois Franchise Disclosure Act, Illinois Compiled Statutes, Ch. 815, Sections 705/18-705/20; Indiana Deceptive Franchise Practices Law, Indiana Code, Title 23, Art. 2, Ch. 2.7, Section 1 *et seq.;* Iowa Code, Title XX, Ch. 523H, Sections 523H.1 *et seq.;* Michigan Franchise Investment Law, Michigan Compiled Laws, Ch. 445, Section 445. 1527; Minnesota Statutes, Ch. 80C, Section 80C.14;

Mississippi Code Ann., Title 75, Ch. 24, Section 75-24-51 *et seq.;* Rev. Stat. Of Missouri 1986, Ch. 407, Section 407.400 *et seq.* and 407.420; Nebraska Franchise Practices Act, Rev. Stat. Of Nebraska, Ch. 87, Art. 4, Section 87-401 *et sea.;* New Jersey Franchise Practices Act, New Jersey Rev. Stat., Title 56, Ch. 10, Section 56-10-1 *et seq.;* South Dakota Franchises for Brand-Name Goods and Services Law, South Dakota Codified Laws, Title 37, Ch. 37-5A, Section 37-5A-51; Virginia Retail Franchising Act, Virginia Code, Title 13.1, Ch. 8, Section 13.1-564; Washington Franchise Investment Protection Act, Revised Code of Washington, Title 19, Ch. 19.100, Sections 19.100.180 and 19.100.190; Wisconsin Fair Dealership Law, Wisconsin Statutes, Ch. 135, Section 135.01 *et seq.;* District of Columbia Franchising Act, District of Columbia Code, Title 29, Ch. 12, Section 29-1201 *et seq.;* Puerto Rico Dealers' Contracts Act, Laws of Puerto Rico Ann., Title 10, Chapter 14, Section 278 *et seq.;* and, Virgin Islands Franchise Business Act, Virgin Islands Code Ann., Title 12A, Chapter 2, Subchapter III, Section 130 *et seq.*

[xxvi] Arkansas Laws, Act 355 (1977) and Act 424 (1979), Section 7.

[xxvii] 642 F.2d 929 (5th Cir. 1981) (applying New York law).

[xxviii] 58 N.Y.2d 298, 461 N.Y.S.D. 232 (1983).

[xxix] 81 F.3d 295 (2d Cir. 1996).

[xxx] 833 F. Supp. 344 (S.D.N.Y. 1993) (New York law).

[xxxi] 833 F. Supp. 288 (S.D.N.Y. 1993) (New York law).

[xxxii] 196 A.D.2d 579, 601 N.Y.S.2d 497 (2d Dept. 1993).

[xxxiii] Not reported in F. Supp., CCH Bus. Fran. Guide ¶10,994 (D.N.M. 1996).

[xxxiv] Not reported in F. Supp., CCH Bus, Fran. Guide ¶10,677 (N.D. Cal. 1995).

[xxxv] Not reported in F. Supp., 1994 WL 13769 (N.D. III.1994).

[xxxvi] 756 F. Supp 543 (S.D. Fla. 1991) *mot. for rehearing denied*, 798 F. Supp. 692 (S.D. Fla. 1992).

[xxxvii] Not reported in F. Supp.; CCH Bus. Fran. Guide ¶10,762 (S.D. Fla. 1995).

[xxxviii] 932 F. Supp. 1420 (S.D. Fla. 1996).

[xxxix] 90 F.3d 1472 (9th Cir. [Cal.] 1996).

[xl] 105 F.3d 664, CCH Bus. Fran. Guide ¶11,078 (9th Cir. 1996).

[xli] 957 F. Supp. 749 (D.Md. 1997).

[xlii] 139 F.3d 1396, CCH Bus. Fran. Guide ¶11306 (11th Cir. December 11, 1997).

[xliii] Not reported in S. Supp., CCH Bus. Fran. Guide ¶11,387 (N.D.Fla. 1998).

[xliv] *Id*. at CCH page 30,555.

[xlv] *Id*. at 30,555.

[xlvi] *Id*. at 30,555, f.n.9.

[xlvii] 169 F.3d 1310 (11th Cir. 1999).

[xlviii] 756 F. Supp. 543 (S.D. Fla. 1991) *motion for rehearing denied* 798 F. Supp. 692 (S.D. Fla. 1992).

[xlix] 2018 WL 8459745 (Sup. Ct. Cal. 2018).

[l] https://www.franchising.com/guides/cobranding_offers_the_best_of_both_worlds.html

[li] Id.

[lii] 16 C.F.R. § 436.5(s)(3).

[liii] 16 C.F.R. § 436.5(s)(3)(ii)(A).

[liv] Id.

[lv] 16 C.F.R. § 436.5(t).