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Evolving Models, Expanding Risks: Advanced Legal Strategies and Considerations for Non- Traditional Franchising

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Exhibit A - Sample Franchise Exemption Acknowledgement

I. INTRODUCTION

For most, the term “non-traditional” in franchising means expanding into captive or semi-captive venues to grow brand awareness and/or unit count. While it may seem ideal for brands to have their logo appear in an airport concourse or on a college campus, getting there takes a lot of time and effort.

Non-traditional franchise development involves expanding beyond traditional retail spaces to high-traffic locations such as airports, military bases, hospitals, and college campuses. Many of these opportunities are available primarily through partnerships with global concessionaires, although possibilities exist for a location to be operated by a franchisor or franchisor affiliate, as well as a traditional franchisee. Technology has also provided brands with the ability to grow virtually through platform-based brand extensions. Co-branded locations present another growth opportunity.

This type of development can offer several advantages, including higher sales volumes that produce higher royalty streams, increased brand visibility, and access to captive and semi-captive audiences. However, it can also come with stricter venue rules and fees, limited or finite lease terms, specialized operator requirements, and the potential for higher product sale prices due to convenience and limited competition.

This paper outlines what franchisors seeking to grow their brands through non-traditional development can do to navigate practical challenges, as well as legal and regulatory ones, such as ensuring compliance with franchise laws and possibly seeking exemptions that may apply to non-traditional franchises.

II. WHAT IS A NON-TRADITIONAL FRANCHISE

Franchised businesses typically are developed and operated with uniform systems, standards, and specifications - uniformity of, among other things, product or service, design and layout, and advertising. Non-traditional outlets often deviate from that uniform system - usually with respect to location, product or service offering, and/or format. “Non-traditional” does not just apply to a venue or a fixed location; alternate formats can include co-branding with other concepts, kiosks or other satellite locations, and e-commerce distribution through digital platforms.

There is a reason non-traditional development has captured so much attention: it is where convenience, visibility and efficiency intersect. Today’s increasingly mobile consumer expects speed and accessibility without sacrificing quality. This creates a powerful opportunity for quick service restaurant (“QSR”) brands that can serve those in-transit moments without requiring a 2,000-square-foot footprint or a lengthy dine-in experience.¹

¹ Bobby Morena, *Scaling Smarter: Modern Formats & Non-Traditional Locations Are Reshaping Franchise Growth*, FRANCHISING MAG. USA <https://franchisingmagazineusa.com/special-feature/scaling-smarter-modern-formats-non-traditional-locations-are-reshaping-franchise-growth/> (last accessed April 12, 2026).

A. Where Non-Traditional Franchises are Found

The non-traditional category encompasses a large and diverse group of channels. Transportation centers include airports, bus and railroad terminals, and travel plazas. The higher-education segment includes over 10,000 colleges, trade-schools, and universities. Entertainment venues include locations such as casinos, theaters, stadiums, theme parks, and destination hotels. Healthcare facilities include large hospitals, medical centers, and complexes, which also are seeing a rise in branded food trucks, and mobile or temporary pop-up locations. Office venues, often referred to as B&I (for “business and industry”), includes office buildings or complexes, convention centers, and even factories. Military bases also fall within the non-traditional category.

Non-traditional venues used to have easily defined barriers, but recent advancement in technology has changed the reach of non-traditional offerings. The rise of third-party aggregators has allowed brands with brick and mortar locations to utilize ghost kitchens² to reach more customers. It has also given rise to brands that are virtual locations³ only. Aggregators in the food and beverage industry are platforms that connect restaurants with customers, streamlining the ordering and delivery process. They offer various benefits, including expanded customer reach, increased orders and revenue, and convenience for customers. However, they also come with challenges such as commission charges and potential lack of point of sale (“POS”) integration, which means the franchisor may have less direct visibility into non-traditional location sales. Franchisors can choose between aggregator models, direct-to-consumer models, or hybrid models to optimize their operations and build revenue channels.

B. Ownership and Management

Many non-traditional venues in the US are operated by large food service contractors commonly referred to as master concessionaires or primes (“Primes”). Primes typically operate all or most of the concessions within a particular venue. The food service contracting industry in the US includes major companies like Aramark and Concessions International, which are based in the US. Other notable companies include Autogrill (Italy), Compass Group and SSP Group (UK), Elior Group, and Sodexo (France). Most of them have been in business for decades, serve thousands of customers each day, and have the resources and financial capability to grow.⁴ The Primes also maintain a robust portfolio

² A ghost kitchen may take different forms, for example, an existing kitchen offering new cuisine or concepts available only through a delivery app; a kitchen located within a commercial or industrial space outfitted with multiple kitchen units, with each operated by different food service operators, or; commissary kitchens from which several brands may operate from the same location. See Tony Marks, *I See Ghosts: The Rise of Delivery-Only Kitchens*, THE FRANCHISE LAWYER, Spring 2021, at 6–7.

³ A virtual location is a restaurant that exists as a delivery only concept, with no brick and mortar location that a customer may visit to either dine-in or pick-up.

⁴ The global market for catering services and food contractors is forecast to reach about \$386 billion in 2029 at a 5.5% compound annual growth rate. See Mike Buzalka, *5 things: Compass North America saw 17.4% revenue increase in fiscal 2023*, FOOD SERVICE DIRECTOR (Nov. 21, 2023), <https://www.foodservicedirector.com/hospital-healthcare/5-things-compass-north-america-saw-17-4-revenue-increase-in-fiscal-2023> (last accessed April 12, 2026).

of approved national, regional, emerging, and local brands that may include brands that compete directly with the franchisors on the street.

Challenges arise when franchisors negotiate with non-traditional franchise operators that are larger and more sophisticated than most traditional franchisees in their system. Unlike the traditional relationship, where the franchisor has more leverage and bargaining power and thus seldom agrees to amend its standard franchise agreement, in the non-traditional franchise environment, franchisors will likely partner with franchisees who have the same, if not more, bargaining power than they do.⁵

In contrast to the sophisticated franchisees that may operate at larger non-traditional venues, franchisors may also contract with much smaller franchisees for smaller non-traditional venues, such as food trucks and kiosks. While some of the unique requirements for non-traditional venues may also apply to smaller non-traditional venues, the negotiation process with these smaller franchisees is likely to be more similar to the negotiation process with franchisees for traditional venues; that is, it is expected that the smaller franchisees will have less negotiating power and will request fewer changes to the form franchise agreement unless required by the venue itself.⁶

C. Shared Facilities

It is common for the operations in non-traditional venues to look different than they do in traditional operations. Many of the Primes operate multiple brands near one another (i.e., food court) and may share resources such as scullery, storage, prep, and cooler space between restaurants. The adjacent seating areas are shared by all the restaurants and typically used by everyone in the building. Having an operations team that understands these nuances can be crucial to a brand's success in non-traditional venues. The Primes also tend to run POS systems that can manage multiple brands within a building, across a campus, or throughout an airport. They likely will not be able to use the software and/or hardware specified by the franchisor. A closer look at these changes and how they are memorialized between parties can be found in Section V (Amendments to the Franchise Agreement).

D. Differences in Product and/or Service Offerings

One of the most significant challenges of operating in non-traditional locations is the authority and influence of the host facility or venue that can create a tri-party arrangement. Landlords of host facilities will have their own separate agreements with the operator that is operating the franchise. Depending on the operational structure of the host facility, these agreements will be leases, subleases, or (if applicable) management agreements. It is uncommon for a franchisor to see or review the contract between the operator and the venue. This "Landlord Agreement" almost always takes precedence over

⁵ Chelsea Severson, Maral Kilejian, & Jonathan Koudelka, Franchise Agreement Provisions You Should Expect to Negotiate When Entering into Non-Traditional Locations, INT'L FRANCHISE ASS'N 52ND ANN. LEGAL SYMP., May 5–7, 2019, at 5.

⁶ *Id.*

a franchisee's license or franchise agreement, and it could potentially require modifications to the material business terms in the franchise agreement, including, but not limited to, changes to the number of product offerings, prices, and hours of operation.⁷ More details on the tri-party arrangements typically found in non-traditional venues can be found in later sections of this paper.

III. DISCLOSURE AND REGISTRATION LAWS

Though the ownership and management structure of a non-traditional franchise may vary from that of a traditional franchise, what the parties call their relationship and how it is structured (whether a partnership, joint venture, license, or otherwise) does not determine whether the relationship is a franchise. If the relationship fits within the definition of a "franchise," then the franchisor must comply with the applicable franchise registration and disclosure laws. For a franchisor with a traditional franchise agreement, if the traditional and non-traditional offerings are similar, the franchisor may be able to easily incorporate the non-traditional offering into its traditional offering by preparing a non-traditional rider to the franchise agreement to address the provisions most likely to require changes (which are discussed below), and addressing differences between the two offerings within the franchise disclosure document ("FDD") itself. However, if the non-traditional offering varies significantly from the traditional offering, the franchisor may need to prepare a different form of franchise agreement and potentially a separate FDD.

As a refresher, under federal law, a franchise is a continuing commercial relationship in which (i) the franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark; (ii) the franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation; and (iii) as a condition to obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.⁸

While most states with franchise registration and disclosure laws have a similar definition of "franchise," there are some differences as compared to the federal law. Therefore, a franchisor must determine on both the federal level, and the state level as applicable, whether the relationship fits within each applicable definition of a franchise.

A. Exemptions and Exclusions

A key benefit of pursuing non-traditional franchising is the ability to partner with a sophisticated franchisee to capture sales in venues that might otherwise be unavailable. An additional benefit of contracting with a sophisticated franchisee is that the franchisor may be able to rely on one or more exemptions or exclusions from federal and state

⁷ Nia D. Newton & Gary R. Batenhorst, *Franchising in Non-Traditional Venues; So Many Options; So Much to Understand*, A.B.A. 44TH ANN. F. ON FRANCHISING, Oct. 13–15, 2021, at 3.

⁸ 16 C.F.R. § 436.1(h) (2007).

franchise disclosure and registration requirements. However, because the particularities of available exemptions and exclusions vary, franchisors relying on an exemption or exclusion should do so with caution.

There are a few possible exemptions from disclosure obligations under federal law⁹. However, even if a federal exemption applies, if a franchise registration state's¹⁰ registration and disclosure laws also apply, the franchisor will need a state exemption or exclusion from registration and disclosure obligations to apply as well. Otherwise, it will need to prepare a franchise disclosure document that covers the non-traditional franchise offering, as further discussed in Section III.b.3. Below is a discussion of some federal and state level exemptions that may apply in the non-traditional franchise context; however, a thorough analysis of every potential exemption is outside the scope of this paper.¹¹

1. Fractional Franchise

Under the FTC Rule, a fractional franchise means a franchise relationship that satisfies the following criteria when the relationship is created: (i) the franchisee, any of the franchisee's current directors or officers, or any current directors or officers of a parent or affiliate, has more than two years of experience in the same type of business; and (ii) the parties have a reasonable basis to anticipate that the sales arising from the relationship will not exceed 20% of the franchisee's total dollar volume in sales during the first year of operation.¹²

Some franchise registration states, including California, Illinois, Indiana, Michigan, Minnesota, New York, Rhode Island, South Dakota, Virginia, and Wisconsin, also have exemptions or exclusions from registration and disclosure requirements for fractional franchises. However, it is important to keep in mind that the fractional franchise exemption or exclusion is not uniform in all states. For example, while Minnesota's fractional franchise definition also requires that the "sales arising from the relationship would represent no more than 20 percent of the dollar sales volume of the franchisee,"¹³ unlike the FTC Rule it does not contain language limiting that requirement to the first year of operation. New York's fractional franchise exemption requirements vary from the FTC Rule in that it requires the 20% of total sales threshold to be met annually¹⁴, not just during the first year of operation of the fractional franchise. Further, it also requires that the new product or service must be "substantially similar or related to those to be offered by the

⁹ FTC Franchise Rule, 16 C.F.R. §§ 436.1–.9 (the "FTC Rule").

¹⁰ Franchise registration states include the following: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin.

¹¹ For a helpful resource that discusses all exemptions and exclusions, see generally *Exemptions and Exclusions Under Federal and State Franchise Registration and Disclosure LAWS* (Leslie D. Curran & Beata Krakus eds., 2017).

¹² 16 C.F.R. § 436.1(g) (2007).

¹³ Minn. Stat. § 80C.01, subdiv. 18.

¹⁴ N.Y. COMP. CODES R. & REGS. tit. 13, §§ 200.10(a)–(c).

franchised business,”¹⁵ which could be more narrowly construed than the FTC Rule’s requirement of “same type of business,” as same type could be interpreted as two quick serve restaurant concepts, whereas “substantially similar or related” may be more narrowly construed than that. Virginia’s law differs in that it excludes from the definition of franchise an agreement under which a retailer of goods or services is granted the right to use a marketing plan or system to promote the sale or distribution of goods or services that are incidental or ancillary to the retailer’s principal business.¹⁶ Though Michigan law provides that a fractional franchise is exempt from both registration and disclosure requirements, it also states that the franchisor has a duty to provide a disclosure document if one exists.¹⁷ The above discussion does not raise every variance that exists between the FTC Rule and the applicable state regulations; therefore, it is important that a franchisor thoroughly analyze whether the prospective franchisee qualifies for the fractional franchise exemption at both the federal and state level, as applicable, before relying on that exemption.

One nearly universal feature of a non-traditional franchisee is that it typically operates in some existing business ecosystem of which the prospective franchise will be part. Therefore, the first prong of the fractional franchise test may be fairly easy to satisfy, either through the operation of the existing business itself or through the experience of its principals or those of a related entity. The second prong of the test is highly-fact specific and requires an analysis of the projected first-year revenue of the franchised business as well as a comparative analysis of the franchisee’s existing income. As a best practice, a franchisor should rely on information submitted directly by the prospective franchisee to the franchisor when confirming application of the exemption (discussed below in Section III.b.1).

Given the sales threshold, a fractional franchise exemption or exclusion may be useful to a franchisor granting a franchisee a license to sell one product from franchisor’s product line at the franchisee’s existing franchised location (for example, Subway® restaurants selling Cinnabon® churros). This exemption may also be helpful for a franchisor seeking to sell a franchise to a Prime that operates all restaurants at an airport terminal.

2. Large Investment

The large investment exemption applies under the FTC Rule when the franchisee’s initial investment, excluding financing received from the franchisor or an affiliate and excluding the cost of unimproved land, totals at least \$1,469,600¹⁸ and the prospective

¹⁵ *Id.* § 200.10(b)(1).

¹⁶ Va. Code ANN. § 13.1-559(B).

¹⁷ Mich. Comp. LAWS §§ 445.1506(1)(h)–(2).

¹⁸ This minimum investment amount became effective July 12, 2024. This amount is adjusted based upon the Consumer Price Index every fourth year.

franchisee signs an acknowledgement verifying the grounds for the exemption.¹⁹ For the exemption to apply, at least one individual prospective franchisee in an investor-group must invest the threshold amount.²⁰ Note that the minimum investment threshold changes periodically according to the Consumer Price Index, and the franchisor should take care to confirm it is using the then-current minimum threshold.²¹

Some franchise registration states also have large investment exemptions; however, in most of those states, the exemption applies only to registration obligations, not disclosure obligations.²² South Dakota has a large franchise investment exemption that closely tracks the FTC Rule exemption, which provides an exemption from both registration and disclosure.²³ Under the applicable South Dakota law, the minimum investment threshold currently is \$1,000,000.²⁴

Interestingly, the availability of the large investment exemption requires analysis of the costs incurred by the franchisee, but before any of those costs are actually incurred. Given that disconnect, it is important that the initial investment is significant enough that, even if some line-item costs end up lower than expected, the variance will not be of such a magnitude that the overall investment falls below the minimum investment threshold.

The large investment exemption may be particularly useful to a franchisor selling a franchise for a business to be located in an airport terminal. Though one might think, given the smaller space in an airport terminal compared to a traditional location, that the investment amount would be lower, it often is the opposite.²⁵ Given the limited and sometimes awkward space in an airport terminal, additional expense may be incurred to have modified plans prepared to fit the business into the space. Further, to work in a secured airport space requires special licenses and permits and comes with its own set of rules and requirements, such as security badging for employees and drug screening. Workers may also be unionized and have higher wages, and airports may have requirements about using minority businesses, so contractors meeting those requirements often are more expensive.²⁶ Additionally, rent is often really high for airport leases.

¹⁹ 16 C.F.R. § 436.8(a)(5)(i) (2007).

²⁰ *Id.*

²¹ *Id.* § 436.8(b).

²² In Illinois, Maryland, and Wisconsin, the large investment exemption only exempts the franchisor from registering the FDD but does not exempt the franchisor from the disclosure obligations. Therefore, the franchisor will need to satisfy the disclosure obligations under the applicable state laws.

²³ S.D. Codified Laws § 37-5B-13(1).

²⁴ *Id.*

²⁵ *Severson*, at p. 8.

²⁶ *Id.*

3. Sophisticated Franchisee

Also under the FTC Rule, there is an exemption if the franchisee (or its parent or any affiliates) is an entity that has been in business for at least five years and has a net worth of at least \$7,348,000. Note that the minimum net worth threshold is adjusted every fourth year according to the Consumer Price Index and the franchisor should take care to confirm it is using the then-current minimum threshold.²⁷

Some franchise registration states also have sophisticated franchisee exemptions; however, in some of those states, the exemption applies only to registration obligations, not disclosure obligations.²⁸ The registration states that provide an exemption from both registration and disclosure for sophisticated franchisees include California, South Dakota, and Washington.

The Washington sophisticated franchisee exemption is based on Washington's accredited investor rules.²⁹ Under the Washington accredited investor rules, there are various options for meeting the sophisticated franchisee threshold, for example, a natural person having income in excess of \$200,000 in each of the two most recent years, or joint income with his or her spouse in excess of \$300,000, and who has a reasonable expectation of reaching the same income level in the year in which the franchise is purchased.³⁰ Unlike the FTC Rule, Washington's exemption does not apply to an entity based on its net worth nor does it allow for reliance on a parent or affiliate's net worth; rather, it provides that an entity with total assets in excess of \$5,000,000 and that was not formed for the specific purpose of acquiring the franchise, may constitute an accredited investor.³¹ This means that while a holding company with more than 5 years' experience (via subsidiaries) may form a new subsidiary to operate a new franchised location and rely on the sophisticated franchisee exemption under the FTC Rule, under Washington law it would not be able to rely on the sophisticated franchisee exemption as the franchisee itself must satisfy the sophisticated franchisee requirements.

Under California law, there are multiple requirements that must be met to rely on the sophisticated franchisee exemption. Some of those requirements are similar to Washington, but California also requires every purchaser of the franchise to have knowledge and experience in financial and business matters, either alone or with professional advisers of the purchaser who are unaffiliated with, and not directly or indirectly compensated by, the franchisor or an affiliate or selling agent of the franchisor, such that the franchisor reasonably believes, based on reasonable inquiry before the sale,

²⁷ 16 C.F.R. § 436.8(a)(5)(ii) and (b) (2007).

²⁸ In Illinois and Rhode Island, the sophisticated franchisee exemption only exempts the franchisor from registering the FDD but does not exempt the franchisor from the disclosure obligations. Therefore, the franchisor will need to satisfy the disclosure obligations under the applicable state laws.

²⁹ WASH. REV. CODE § 19.100.030(5).

³⁰ WASH. ADMIN. CODE § 460-80-108(6).

³¹ WASH. ADMIN. CODE § 460-80-108(3).

that each and every purchaser has the capacity to evaluate the merits and risks of, and protect their own interests in, the franchise investment.³²

B. Mitigating Legal Risks

1. Due Diligence

When relying upon any exemption from registration and disclosure laws, it is imperative that the franchisor does its due diligence on the prospective franchisee and its business operations. The exemption upon which the franchisor intends to rely will determine, in part, the scope of information the franchisor will need to obtain from the prospective franchisee.

With respect to the fractional franchise exemption, it is important to note that the rule places the burden on both parties. Specifically, it says that “*the parties* have a reasonable basis to anticipate that the sales arising from the relationship will not exceed 20% of the franchisee’s total dollar volume in sales during the first year of operation.”³³ Note that the rule does not say “the franchisee” anticipates its sales will not exceed 20%. This means that the franchisor will need to request sufficient information and documentation from the prospective franchisee, related to the prospective franchisee’s existing business operations, to get comfortable that the prospective franchisee’s sales from the franchise will not exceed 20% of its sales, and that the prospective franchisee agrees with the franchisor’s analysis. For example, the franchisor could require the prospective franchisee to conduct its own analysis of the projected first-year revenue and submit that information to the franchisor for independent review. In doing so, the franchisor obtains the projected revenue without accidentally providing the prospective franchisee with information that might conflict with disclosures made in Item 19, if any, considering the franchisor will not yet have determined whether the exemption applies. If the franchised location is in a registration state such as Minnesota or New York, it may be more difficult to get comfortable with that anticipation if the term of the franchise agreement is more than a couple of years long, given that those states do not limit the 20% cap to the first year of operation of the franchised business.

For the large investment exemption, as noted above, reliance on the exemption occurs before any of those investment costs are actually incurred. Therefore, the franchisor should collect a buildout cost form from its non-traditional franchisees to document costs actually incurred, which it can then use to analyze the estimated initial investment going forward. The franchisor should also be prudent in obtaining cost estimates for products and services for which it designates suppliers or sets standards and specifications.

If the franchisor intends to rely on the sophisticated franchisee exemption, the franchisor will likely need to request a variety of documents and information. For an entity,

³² CAL. CORP. CODE § 31109(b).

³³ 16 C.F.R. § 436.1(g) (2007) (emphasis added).

the franchisor should consider requesting audited financial statements for the past five years, corporate documentation reflecting formation and good standing, and if the franchisee is relying on an affiliate or parent company's experience, the same information for that entity. If either the time in existence or the net worth requirement is being satisfied by a parent or an affiliate of the prospective franchisee, the franchisor should also review an organizational chart showing the ownership relationship between the prospective franchisee entity and that other entity. For individuals, the franchisor will need to verify employment history, obtain W-2s or 1099s for the last two years, obtain contact information for such individual's advisors, or if the individual is not relying on an advisor, understand the scope of the individual's past business experience and whether that experience gave them the ability to evaluate the merits and risks of the opportunity.

2. Documenting reliance

If after completing its due diligence the franchisor has determined it has a reasonable basis to rely on an exemption or exclusion from registration and disclosure obligations, the franchisor should document that reliance. While the FTC Rule large investment exemption expressly requires the prospective franchisee to sign an acknowledgment and prescribes the acknowledgment language,³⁴ not all exemptions expressly require the prospective franchisee to sign an acknowledgment. However, best practice is to have a prospective franchisee sign a franchise exemption acknowledgment indicating all exemptions that apply, both at the federal level and the state level. For the large investment exemption, the franchisor may be in a better position to have the prospective franchisee sign an exemption acknowledgment earlier in the process as the franchisor can use information from its own experience, or from the experience of its affiliates or existing franchisees, to determine the estimated initial investment. For the exemptions that rely on the franchisee's information, it may take longer to verify that it has sufficient information to rely on the fractional franchise or sophisticated franchisee exemption. Regardless of whether the franchisee signs the acknowledgement, the obligation is still on the franchisor to conduct due diligence to verify it has a reasonable basis to rely on such exemption.

Depending on when in the process the franchisor obtains sufficient information to verify the exemption(s) upon which the franchisor may rely, it may be prudent to have the prospective franchisee sign a franchise exemption acknowledgment early in the process, well in advance of signing the franchise agreement. A sample franchise exemption acknowledgment for the FTC Rule exemptions is attached as Exhibit A. This may be particularly important if the franchisor does not otherwise have a franchise disclosure document prepared for its non-traditional offering, whether because it is new to the non-traditional space or because it typically only offers and sells non-traditional franchises when an exemption applies.

In other instances, the franchisor may not be in a position to have the franchisee sign a franchise exemption acknowledgment prior to the franchise agreement. For example, the prospective franchisee may indicate on an application that it meets the

³⁴ See *id.* § 436.8(a)(5)(i).

minimum income or net worth requirements but does not provide copies of all requested supporting financial information to the franchisor until immediately prior to signing the franchise agreement. In those instances, the franchisor may instead include the acknowledgment in the franchise agreement or an amendment to the franchise agreement. Below are sample franchise agreement provisions that can be customized by parties relying on an exemption in connection with a non-traditional franchise arrangement:

“Fractional Franchise Exemption. Franchisee, or a current officer or director of Franchisee or its parent company or commonly-owned affiliate, has more than two years of experience in the same type of business that Franchisee will operate under the terms of this Agreement. Franchisee reasonably anticipates that the combined sales revenue arising from the operation of the unit authorized under this Agreement will not exceed 20% of Franchisee’s total revenue from all business activities in any calendar year during the term of this Agreement. As a result of the representations made in this section, the parties acknowledge their mutual intent that the arrangement provided for in this Agreement is exempt from 16 CFR § 436 and any corresponding applicable state law because it qualifies as a “fractional franchise” within the meaning of 16 CFR §§ 436.1(g) and 436.8(a)(2) and under any applicable state law.”

“Sophisticated Franchisee Exemption. Franchisee, or its parent company or commonly-owned affiliate, has been in business for at least 5 years, and Franchisee(or its parent company or commonly-owned affiliate), has a net worth of at least \$7,348,000. As a result of the representations made in this section, the parties acknowledge their mutual intent that the arrangement provided for in this Agreement is exempt from 16 CFR § 436 and any corresponding applicable state law pursuant to the exemption provided for under 16 CFR § 436.8(a)(5)(ii) and under any applicable state law.”

3. Preparing a Franchise Disclosure Document

Depending on where the franchisor intends to offer non-traditional franchises, and the availability of exemptions and exclusions in those states, the franchisor may need to prepare, and in some states register, the franchise disclosure document for its non-traditional franchise program. If that is the case, the franchisor will need to determine whether it will prepare a separate non-traditional franchise disclosure document or if it will include the non-traditional offering in the same franchise disclosure document as its traditional offering.

To make that determination, the franchisor needs to first consider its target markets for its non-traditional offering. Is the franchisor seeking to offer non-traditional franchises primarily at captive locations such as airports and stadiums? Is the target market semi-captive locations such as malls, healthcare systems, and university food courts? The more similar the offering to the traditional offering, the more likely it makes sense to include the traditional and non-traditional offering in the same FDD.

The franchisor also needs to consider whether it will use the same form franchise agreement, albeit with a non-traditional addendum to address terms that vary, or whether

non-traditional franchisees will sign a completely different form of franchise agreement than traditional franchisees. If the form of agreement to be signed by traditional and non-traditional franchisees varies significantly, then two separate FDDs may be necessary. As further discussed below in Section V, consideration should be given to various terms of the franchise agreement and whether they need to be modified to account for the differences in non-traditional locations.

When deciding whether a separate FDD is necessary, consider how different the terms of the offering will be between traditional and non-traditional. Will the initial amounts payable to the franchisor differ? The royalty rate often varies, and non-traditional franchisees are often not required to contribute to the advertising fund if they are not expected to benefit in the same way as traditional locations. Will other ongoing fees differ? Certainly, the estimated initial investment will require a separate chart, possibly more than one for non-traditional outlets depending on the types of non-traditional locations the franchisor is offering. For example, an airport location estimated initial investment is likely to differ from a university location or a ghost kitchen.

Non-traditional locations can also differ from traditional locations with respect to product offerings, supplies, and suppliers. For example, large and sophisticated non-traditional franchisees may have their own vendors and suppliers that they use for their other brands and may want to achieve economies of scale (and convenience) by using those suppliers, where appropriate, for a new location. For a non-traditional location that is part of a larger venue, the owner or landlord of the venue may have their own rules and requirements that the franchisee must comply with to be in that space. For example, a stadium owner may have an agreement in place to offer only Pepsi products. If the franchisor has an agreement to offer only Coca-Cola products, then that conflict must be resolved, or the franchisor and franchisee may lose out on that opportunity. Therefore, the franchisor may have to review their vendor contracts, and even renegotiate them, if necessary, for non-traditional franchisees. As a result, Item 8³⁵ disclosures may vary for the non-traditional franchise offering.

Depending on the experience level of the non-traditional operator and how limited the non-traditional location's product offering is compared to the traditional offering, the training needed may be significantly reduced and therefore require a different training program chart in Item 11.³⁶ For non-traditional locations that are part of a larger venue, particularly where the franchisee operates multiple different businesses in the venue (for example, food courts, airport concessions, or ghost kitchens), the franchisee having a

³⁵ Item 8 discloses 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, approved suppliers, or under the franchisor's specifications. See *id.* § 436.5(h).

³⁶ In Item 11 of the FDD, the franchisor must disclose both pre-opening and operational assistance it will provide to the franchisee, including training and advertising, among other things. Item 11 also contains disclosures regarding required computer systems. See *id.* § 436.5(k).

separate POS system for each of the businesses may not be reasonable; therefore, the Item 11 disclosures will vary.

When it comes to making financial performance representations, is there a reasonable basis to include traditional and non-traditional locations in the same financial performance representation? The answer, most likely, is no. Therefore, separate financial performance representations will be required. Separate Item 20 tables³⁷ likely will also be required.

The above is not an exhaustive list of the ways the traditional and non-traditional offerings may differ. Careful consideration should be given to all the variances between the traditional and non-traditional offerings. The more variations between the franchisor's non-traditional and traditional locations, the more likely it is to make sense to have two separate FDDs.

The franchisor also should consider its target prospective franchisee. If the franchisor is likely to have a prospect that would be interested in buying both a traditional and non-traditional franchise, then having both offerings in the same FDD would make sense to provide a side-by-side comparison of the traditional and non-traditional offerings. If there is likely few prospective franchisees that would buy both, then keeping the offerings separate could make more sense so prospects do not have to wade through extra information.

C. Regulatory Friction Points

The FTC Rule requires specific disclosures to be included in the FDD, and if a particular disclosure does not apply, the franchisor still must answer the question stating that it does not apply. Further, the FDD may only include information that is responsive to the FTC Rule (and state laws, to the extent they require additional disclosures). At times, this can create friction between the required disclosures and the franchisor's ability to adequately disclose all information related to the franchisor's non-traditional offering.

This may be particularly true in the case of a sophisticated franchisee. In some instances, estimating the initial investment may be difficult, and the franchisee may be in a better position to determine the estimated initial investment for the particular location. For example, if a prospective franchisee operates in a captive market venue that imposes its own requirements, the venue's requirements may significantly impact the typical initial investment. Also, a Prime with extensive experience operating in the particular captive market venue may be better suited to estimate the initial investment based on its own past experience completing buildout in the captive market venue. Regardless, as

³⁷ In Item 20 of the FDD, the franchisor is required to include five tables, with each of the first four tables providing a three year look back. Table 1 summarizes the number of franchised and company outlets open at the beginning and end of each of the last three fiscal years. Table 2 is a state-by-state summary of franchised outlet transfers. Table 3 summarizes franchised outlet openings, closures, terminations, and other activity by state. Table 4 summarizes corporate outlet openings, closures, and other activity by state. Table 5 provides projected openings of new outlets by state during the upcoming fiscal year. See 16 *id.* § 436.5(t).

discussed above, the franchisor still may need to prepare an FDD and therefore an estimated initial investment if an exemption or exclusion is not available.

Often times, if a franchisor wants to close a deal with a prospective franchisee that operates as a Prime, it will have to negotiate certain requirements that the Prime may be unwilling to agree to. For example, if the Prime has certain suppliers from which it obtains most of its products and supplies, it may be unwilling to use the franchisor's designated suppliers; or, if it has a POS system that it uses for all its locations within a particular captive or semi-captive venue, the franchisee may be unwilling to use franchisor's required computer system. In that case, the franchisor may have to heavily negotiate the deal in order to sell the franchise. That may mean the disclosures regarding products and services in Item 8 of the FDD, and the disclosures regarding the computer system in Item 11 of the FDD (including ongoing costs), are irrelevant to the prospective franchisee. If the franchisor's target market for its non-traditional locations or its target franchisees for its non-traditional locations are of the type described above, the franchisor must be prepared to negotiate if it wants to sell the franchise. In this case, the franchisor may question the need to prepare the FDD and why it must disclose the prospect with an FDD, when it knows that numerous disclosures ultimately may not apply to the prospective franchisee. This is where exemptions can be helpful. However, since not all registration states have exemptions or exclusions available, franchisors may need to deal with the friction between the legal requirements and preparing a disclosure document that is both compliant and useful to a prospective franchisee.

There may also be regulatory friction when there are franchised businesses that are co-branded locations and for which each brand is offered by a different franchisor. In that case, the franchisors must determine whether there is an overlap in disclosures. How closely intertwined are the two brands? Are they actively promoting co-branding or simply allowing it? For franchisors actively promoting co-branding, do the two brands share components of their business at the franchised location, or are they simply operated side by side from the same location? If they are intertwined, how does each franchisor satisfy its disclosure obligations for the co-branded location without including prohibited disclaimers? For example, with respect to the estimated initial investment, how are rent and buildout costs allocated among the two locations? When it comes to meeting system standards, if the standards vary between the brands, how will differences be resolved? All of this must be carefully considered and even more carefully described in each franchisor's FDD, with care taken to explain the impact the other brand will have on the co-branded location.

The FTC Rule disclosures do not directly contemplate that scenario, nor do they allow disclaimers. Therefore, franchisors and their attorneys must carefully consider how co-branded locations will be operated and how that differs from a traditional location or even from other non-traditional locations that are not co-branded. They also must consider whether all co-branded locations will be operated in a similar manner or if they may vary from location to location. If they may vary, do those variances warrant additional disclosures? For example, if one brand is anticipated to be the primary brand of a co-branded location in some locations but the secondary brand in other locations, do the estimated initial investments vary so much so that two separate Item 7 charts are

warranted? The franchisors will also need to consider the impact that may have on other FDD disclosures as well, such as financial performance representations.

Before including financial performance representations in its disclosure document for non-traditional locations, the franchisor will need to closely analyze the data and how it varies among different types of non-traditional locations. While the franchisor may want to include financial performance representations for all its non-traditional outlets, it is important to remember that financial performance representations should include an apples-to-apples comparison, and there must be a reasonable basis for including the information. That likely means including separate financial performance representations for different types of non-traditional locations, as an airport location is likely to have significant variation in operations and performance as compared to a university dining hall or a food truck.

IV. QUALIFYING NON-TRADITIONAL FRANCHISEES

If the operator pursuing a non-traditional franchise is a company, it may be difficult to obtain applications and/or personal financial statements from individuals, particularly from persons employed by large, publicly traded entities. Obtaining financial statements from the prospective franchisee, along with copies of its organizational documents, is prudent. However, be prepared that during initial discussions the prospective franchisee may request a mutual non-disclosure agreement before sharing information that may not be public knowledge.

Franchisors can modify qualification requirements and internal procedures to be applicable to a company as opposed to an individual. For example:

- **Research the Company:** Much information is publicly available on the internet or through a company-hosted website. It may be easy to determine how long they have been in business, brands in their portfolio, and locations of existing operations.
- **Evaluate Business Readiness:** Ensure the business is profitable, financially viable, and has a reputation for completing projects on time and on budget.
- **Understand Operations:** Find out how they structure their operations inside the venue so the franchisor's operations support team can understand differences before the location begins operations.

As a bonus, the information provided can assist the franchisor in determining what, if any, franchise exemptions may apply.

V. AMENDMENTS TO THE FRANCHISE AGREEMENT

As mentioned above, a franchisor typically needs to amend its traditional franchise agreement so it applies to a non-traditional location. Sometimes, revisions are necessary based on the experience and sophistication of the non-traditional franchisee. Other times they are based on the type of non-traditional location being targeted, as a captive location

within a larger venue may have different constraints and requirements than a traditional location. Though the below is not an exhaustive list, the franchisor should consider whether it is necessary to revise the following terms of its standard franchise agreement, or whether flexibility in the application of its brand standards is sufficient to address the variances.

A. Operational Involvement Requirements

A common requirement in traditional franchise agreements is that the individual franchisee agrees to be actively involved in the day-to-day operation of the franchised business. This ensures that the franchisee selected by the franchisor is actually the party operating the unit and that the franchisee is not simply a passive investor or signatory.

In a non-traditional franchise agreement, this requirement will most likely require modification. Because non-traditional franchisees often are a larger business entity, not an individual or closely-held small business, provisions requiring personal and individual involvement in the business by an individual franchisee or its owner may require adjustment to state that the franchise is being granted to the franchisee entity itself and that the location should be operated by employees of the franchisee entity, overseen by a manager or other control person approved by the franchisor.

In some non-traditional locations, like colleges and universities, healthcare centers, and hotels, a third party may be responsible for the day-to-day operation of the franchised location. As an example, consider a scenario where a food and beverage franchisor enters into a franchise agreement allowing a state university to operate a branded franchise location. At the university, all food and beverage outlets are managed by a national concessionaire. In that case, franchise agreement provisions requiring the franchisee university to operate the unit on a daily basis would need to be modified to allow for the university franchisee to delegate the right to conduct daily operations to the concessionaire.

Such an arrangement would likely require other corresponding agreement revisions. It could drive modifications requiring the concessionaire to operate the unit as directed in the franchise agreement, which may be achieved by a joinder to the franchise agreement in which the concessionaire agrees to be bound by certain provisions of the franchise agreement. It may drive updates requiring the franchisee university to ensure that the concessionaire abides by the franchise agreement and operations manual while also maintaining the franchisee university as the party ultimately responsible for performance of franchise agreement obligations, including payment obligations. In such a scenario, careful drafting is necessary to allow the degree of operational flexibility required to function within a non-traditional venue while also maintaining contractual protections for the brand.

B. Real Estate Requirements

In many non-traditional franchise arrangements, the franchisee entity will not own the physical space where the franchised unit is located. Instead, it is common for the

franchisee entity to rent the physical space for the franchised location from a landowner with whom the franchisor has no direct contractual relationship. By way of example, a concessionaire may be the designated food and beverage provider for a hospital. The franchisor could grant the concessionaire the right to operate a franchised location at the hospital pursuant to a franchise agreement between the franchisor and the concessionaire. The concessionaire, obviously, is not the owner of the physical premises in the lobby of the hospital and does not have exclusive lease rights to a building. But it has access to that location pursuant to a lease between the concessionaire and the hospital.

In such a typical single-site franchise arrangement, a franchisor may require a tri-party lease rider between the franchisor, franchisee, and the landowner, to protect the franchisor's brand and interests. A lease rider is a document containing new lease terms that attaches to and modifies the lease between the franchisee and the landlord. Lease riders are a tool for franchisors to influence the lease arrangement even when they are not in contractual privity with the parties to the lease. Typically, lease riders contain provisions favorable to the franchisor, such as granting the franchisor notice, step-in, and enforcement rights. However, given the leverage held by many landlords of non-traditional venues, franchisors should be aware that lease riders are uncommon in non-traditional franchising and this specific tool may be unavailable.

Instead, in non-traditional franchise arrangements, the franchisor must modify the franchise agreement to protect its interests when possible while also recognizing that it may need to accept some level of risk to gain entry to a typically captive venue. In particular, the franchise agreement should provide that it is a default of the agreement if the franchisee loses the right to occupy the franchised location, whether through expiration or termination of such rights, and that any failure to cure a material breach of the occupancy agreement between the franchisee and the landlord also constitutes a default of the franchise agreement. Including such a provision allows the franchisor to act under the franchise agreement and potentially terminate the franchise agreement if the franchisee no longer has access to the property. This protects the franchisor by allowing it to end the franchise relationship if the franchisee's access to the property is removed and, if such right is exercised, eliminates any argument the franchisee could raise that it is still entitled to operate the franchised location, perhaps at an alternate space, despite losing access to the property.

C. Personal Guarantees

Another common feature of many franchise agreements is that one or more individuals personally guarantee the financial obligations of the franchisee. This provides the franchisor with assurance that if the franchisee does not pay the franchisor, the franchisor can seek payment from the guarantor.

In non-traditional franchising, personal guarantees are a rarity. That is because the franchisee itself is usually an entity with other entities as its ultimate owners. Individual owners are uncommon and, even if located within the broader organizational structure,

are likely to have only a tangential relationship to the operation of the franchise, making them unlikely to serve as voluntary guarantors.

Franchisors do, however, have other options to mitigate financial risk. First, and foremost, it is important to recognize that the risk profile of a non-traditional franchisee may be somewhat lower than that of a typical individual franchisee. That is because non-traditional franchisees typically already have existing lines of business and sources of revenue that arguably make franchisee insolvency less likely.

That said, non-traditional franchise arrangements certainly are not risk-free. To further reduce financial risk, franchisors could consider establishing a minimum revenue or net worth level at which it is comfortable proceeding without any security. If the prospect's means fall below that figure, the franchisor could opt to require some form of security from the franchisee. The franchisor could require that the franchisee provide a security deposit that the franchisor holds on file and can draw against in the event of a monetary default. Another option could be requiring the franchisee to provide a letter of credit that the franchisor can execute upon should a payment default occur.

D. Territory

Often times, the franchisor grants territorial protections to a franchisee, whether based on a radius around the outlet, an area encompassing a minimum population, or certain geographical boundaries. One of the reasons is to give the franchisee some protection from cannibalization of its business by placing another outlet nearby. However, that same rationale often does not apply for non-traditional locations, especially those in captive markets. A consumer looking for a coffee shop cannot enter secured areas of the airport simply to buy a cup of coffee. Therefore, a coffee shop in an airport does not need the same area of protection as a traditional location to prevent cannibalization of its business. In that case, the franchisor may opt to remove territorial protections.

However, that analysis may be different for a coffee shop placed in a semi-captive location such as a grocery store. In a semi-captive market, consumers have the option to either buy their coffee before going to the grocery store and bring it with them, or they can buy the coffee when arriving at the grocery store to enjoy while shopping. Consideration needs to be given to the type of semi-captive market at issue, as in the example above there may be some cannibalization between the non-traditional outlet within the grocery store and a traditional outlet located in the same strip mall as the grocery store. Therefore, for a semi-captive location, territorial protections may still be warranted, although they may be significantly reduced in size compared to the size of a traditional location's protected territory.

Further, for a co-branded location, or a license arrangement by which a branded outlet is licensed to offer certain products sold by another brand (consider the example given above of Subway® restaurants selling Cinnabon® churros), the need for the territorial protections should be considered. In the Subway® example, where the Subway® franchisee is given a license to sell one product line from a Cinnabon® business, the Subway® franchisee's sales from Cinnabon® churros are likely to be a small portion of

their sales. It is unlikely that customers are going to Subway® specifically to buy only a churro. Rather, they are there to buy a sandwich and may buy a churro for dessert out of convenience. Therefore, in that limited license arrangement, the Subway® franchisee is unlikely to be given territorial protection (either contractually or by application of any existing site approval policies) for the sale of Cinnabon® churros.³⁸

With a co-branded location, each brand likely will still have territorial protections, but consideration needs to be given to whether any modifications to those territorial protections are necessary. Consider, for example, a sign and graphic business that wants to co-brand with a marketing and printing business. They are two distinct businesses, though there may be some overlap in the types of products and services they offer. The territorial protections for each business ordinarily might prohibit the placement of one business within two miles of the other, though their services are complementary. Therefore, to allow for the co-branding of the outlet to include both businesses, the franchise agreement for each outlet may need to be modified to provide an exception to the territorial protections for the co-branding of the location. When both brands are offered by the same franchisor, that will not be an issue. If the franchisor of each brand is different, that will require agreement and cooperation between the franchisors to modify each agreement. See below for additional consideration for co-branding outlets.

E. Encroachment

If the franchisor has traditional locations, it also must consider territorial protections given to its traditional franchisees and whether the placement of a non-traditional location within their territory is a breach of the existing franchisee's territorial protection or the franchisor's customary site approval policies. Even when a traditional franchisee is given territorial protections, the franchisor typically retains certain rights to operate businesses that could impact the franchisee's business. If the placement of a non-traditional location is not specifically excluded from the territorial protections granted to an existing franchisee, the franchisor will not be able to place a non-traditional outlet within the traditional franchisee's territory, even if the location is a captive location and therefore not at risk of cannibalizing sales from the existing franchisee.

Therefore, when drafting the franchise agreement, both for traditional and non-traditional locations, careful consideration needs to be given to the exceptions to territorial protections. The same is true for any site selection and approval processes or policies. Even if the franchisor does not have immediate plans to enter captive or semi-captive locations, thought should be given to potential future expansion plans to reserve the franchisor's right to non-traditional expansion. The carveouts may vary based on the franchisor's business model and may be especially delicate when considering ghost kitchens or mobile units, which are more likely to cannibalize sales from an existing traditional franchisee. In that case, a franchisor may consider including a provision that allows it to place a ghost kitchen in the franchisee's territory if the franchisee does not satisfy certain delivery requirements. The franchisor may consider allowing the operation

³⁸ The authors have not reviewed the license agreement for that arrangement and therefore are not indicating what the actual arrangement between those parties entails.

of a mobile unit within the franchisee's territory, provided that franchisor gives the franchisee the right of first refusal to acquire a franchise to operate that mobile unit. Each franchisor needs to carefully consider its business model, and how it may want to expand in the future, otherwise it may lock itself out of certain markets unless it is able to obtain a waiver from an existing impacted franchisee.

F. Supply Chain

As noted above with respect to disclosure requirements, pursuing a non-traditional franchise relationship may require the franchisor to approach its franchise supply chain somewhat differently, which could affect franchise agreement drafting. Some non-traditional franchisees have their own supply chains and rely on that existing structure to drive efficiency and manage costs within the franchised businesses they operate. Examples could include airports, universities, and hospitals who may have their own commissaries or procurement functions. A "commissary" in the non-traditional franchise context means a back-of-the-house kitchen and supply hub where food and beverages are prepared and later offered for sale at one or more customer-facing outlets within the larger venue.

If a franchisor engages with a non-traditional franchisee that uses a commissary, it may consider revising existing food preparation standards to allow use of the commissary. If a franchisor engages with a non-traditional franchisee that has its own procurement function, a franchisor may consider allowing the franchisee to purchase non-proprietary items through its existing franchisee procurement channels, using its existing relationships. Often, operational compromise is a necessary trade-off when expanding via non-traditional venues.

G. Hours of Operation

Similarly, certain non-traditional franchise locations may require franchisors to relax their minimum hours of operation requirements. College and university campuses and certain hospitality resort locations are noteworthy venues with significant seasonality driven by periods of closures or low customer traffic. Grocery stores, theme parks, mass retailers, and other businesses already have their own hours of operation. Franchisors entering those channels need to ensure the required hours of operation for the franchise outlet fit within the operating hours and schedule of the larger venue. If not, then modifications of these requirements may be necessary, or must be negotiated with the venue.

H. Pricing

Franchisors wishing to enter certain non-traditional franchise channels should be prepared to experience higher levels of complexity surrounding franchisee pricing.

In the gaming, amusement, and hospitality channels, it is not uncommon for franchisees to set the prices for products sold at franchise locations at a higher price point compared to franchisees in traditional locations. The rationale for differentiated pricing is tied to the channel itself. Given that customers within these venues are often captive, the

operator may wish to capitalize on the higher demand and limited competition to command premium pricing.

Franchises operating in airports also tend to experience complexity surrounding retail pricing. Some franchise operators in airports add fees to cover the elevated cost of labor related to hiring airport workers. Including such fees can become a sensitive topic for customers. To reduce brand friction related to these fees, franchisors should consider providing guidance to airport franchisees requiring lawful, accurate, and complete disclosure regarding the imposition of such fees.

On the flip side, franchisors operating in airports should also be aware that some government entities that own or operate airports place rules and regulations on the prices charged by business operators within the airport. For example, an airport authority could mandate that prices for food and beverages sold at the venue cannot exceed a defined percentage of the comparable price charged by the same or a similar business in the metropolitan area in which the airport is located. These rules may not necessarily drive changes to the franchise agreement. Nevertheless, franchisors should be aware of these pricing-related rules and the operational complexities they cause, and be prepared to be flexible in the application of brand standards if necessary.

I. Workforce Issues

Franchisors should also be aware that expanding in non-traditional venues often means navigating challenging workforce issues. As noted previously in this paper, some non-traditional venues are simply more difficult, and expensive, places to hire. Workers in airports must pass rigorous security screening every day. Workers in theme parks and ski resorts may have to commute to geographic locations that are somewhat remote and may have limited options for nearby accessible and affordable housing. These realities may not require changes to the franchise agreement or operations manual, but franchisors should still take note because these issues may cause downstream effects on pricing and franchisee profitability.

Additionally, some non-traditional venues, like grocery stores, airports, and hotels, often have unionized workforces, which can create complexity both for the franchisee as employer and for the franchisor as brand owner seeking to maintain a consistent operating model. Franchisors may need to amend franchise agreements to clarify which document will control in the event of a discrepancy between the terms of the franchise agreement and operations manual on one hand and the applicable collective bargaining agreement on the other.

J. Vendor Requirements

Some non-traditional franchise venues require that vendors, including franchisors, meet specified requirements in order to access the site for inspections or to sell product to the franchisee. Specifically, some state colleges and universities require franchisors selling items to the college register as a vendor and update that registration on a regular basis. Casinos, certain tribal-owned venues, airports, and train stations may also require

franchisors to obtain and maintain certain vendor approvals. Obtaining vendor approval can be an intensive process and often requires payment of registration fees and disclosure of sensitive franchisor information. Again, these requirements may not require changes to the franchise agreement or operations manual but are business realities that franchisors will need to navigate post-contract in order to implement the operating system within a non-traditional venue.

K. Non-Compete

Securing non-competes against the ownership or operation of “competing” brands may not be possible in any capacity. Primes and other large concessionaires usually own and operate their own proprietary brands at airports and other venues, and/or operate many other brands, all of which may be in direct competition with the franchisor (even within the same airport or other venue).

Also, after termination, expiration, or non-renewal of the franchise, the lease will revert to the landlord who may wish to replace the franchised brand with another similar concept, especially if the venue desires to continually have varied offerings with similar cuisines. This makes obtaining a post-term non-compete very difficult and, if the franchisor manages to get one, it may not be enforceable. Once that lease has expired the franchisee has little or no ability to control what brand or type of cuisine goes into the vacated space.

Larger and more sophisticated operators are unlikely to accept standard non-competes. But there may be other options for the franchisor. For example, an airport franchisee may agree to more limited restrictions on competitive activities in the same airport (or terminal in the same airport) or that derive a percentage of revenue from directly competing products. Concessionaires with their own proprietary concepts, however, will likely reject any restrictions on the development of their own concepts.³⁹

L. Data Access

Franchisors often require franchisees to use specific computer systems, including the POS system. That allows the franchisor to obtain information from its franchisees in a uniform manner, and often allows the franchisor to access the computer system directly to obtain sales and other information. However, this is not always feasible or practical for non-traditional locations. When there is one Prime that operates all the locations in a food court, it may be unwilling or unable to use the franchisor’s POS system as it will want to use one POS system for all the businesses it operates in the food court rather than multiple different systems. Therefore, the franchisor will need to consider not only modifications to its computer system requirements, but also to the reports the franchisee must submit. If the franchisor typically relies on its access to the POS system to gather data related to sales, additional reports may be required. If the location is in a food court that has a common fountain beverage dispenser, the franchisor may require additional

³⁹ Abhishek Dubé & Rocio Deitz, *A “High-Level” Overview of Airport Franchising*, THE FRANCHISE LAWYER, Winter 2022, at 8, 10.

reports related to all beverages sold and the allocation of beverage sales among the various restaurants. Where the food court is located in a university such that dining plans may be used to pay for food and beverages, consideration should be given to whether any additional reports are needed.

Franchisors also typically reserve audit rights, which require access to the franchisee's books and records, so that they can verify that the information the franchisee has provided is accurate. When the POS system contains information from sales related to other brands, the franchisor may need to agree to confidentiality of any information it may have access to that does not pertain to its brand. This provision may be particularly difficult to negotiate with non-traditional outlets located in healthcare venues as there are stringent laws related to protection of healthcare information. Therefore, if the franchisee's computer systems are connected on the back-end such that providing the franchisor access to books and records related to the franchised business could also give the franchisor access to protected healthcare information, the franchisee may be unable to agree to the franchisor's audit rights.

M. Co-Branding

A thorough analysis of co-branded locations is beyond the scope of this paper. However, it is important to note that co-branding of locations that have different franchisors may take different forms. There may be permissive co-branding, meaning the franchisors allow their franchisees to participate in co-branding relationships without a formal agreement between the concept owners.⁴⁰ In that case, the franchisor may consider the co-branding of a location on a case-by-case basis, and document agreed upon terms with each franchisee as needed in a negotiated amendment to the franchise agreement.

There is also promoted co-branding, meaning the brand owners actively and directly promote the co-branding of the concepts.⁴¹ In that case, the franchisors will need to consider what impact the co-branding of the location will have on their brands. Will the locations be separate and distinct, albeit at a shared location, such that each will primarily retain its brand standards without much, if any, modification? Or will the co-branded location be blended such that modification to some standards for each brand will be necessary? Depending on the variances, the franchisor should consider the use of a co-brand addendum to the form non-traditional franchise agreement that specifically addresses any necessary modifications to trade dress, signage, POS system, reporting, fee sharing, and a host of other potential issues.

N. Termination and Exit

Non-traditional franchise arrangements merit providing special attention to termination and exit provisions. For example, franchisors may wish to revise the franchise

⁴⁰ Kim A. Goodhard & W. Andrew Scott, *Co-Branding*, A.B.A. F. ON FRANCHISING, Oct. 22–24, 1997, at 4–5.

⁴¹ *Id.* at 4.

agreement to have explicit rights to terminate the franchise agreement if the franchisee is in default of its lease with the venue owner or if it violates rules and regulations established by the larger venue, such as venue-mandated pricing, hours, or staffing requirements. On the other hand, concessionaire franchisees may want to add additional flexibility to the franchise agreement allowing a penalty-free termination right if the concessionaire loses its bid to remain the preferred food and beverage provider at the broader venue.

O. Tri-Party / Institutional Arrangements

As previously stated, growth in non-traditional venues is typically done via tri-party arrangements where the franchisee has one contract with the landlord and another with the franchisor. The franchisee must manage both relationships, especially when the obligations of one may be in direct conflict with the other. It is imperative for all sides to understand the tri-party power dynamic that exists in many non-traditional channels.

VI. RULES OF ENGAGEMENT FOR GROWTH AND PRACTICE POINTERS

Franchisors expanding into non-traditional venues may find themselves in a surprising and uncommon position. That is because non-traditional franchisees typically are not individuals or small businesses run by their individual owners, but rather entities with successful existing businesses in their own right. Further, non-traditional franchisees may have significant leverage given that they often hold the keys to accessing a coveted captive venue. These realities can require franchisors to shift their mindset, especially around franchise agreement negotiations. Franchisors that successfully navigate non-traditional venues understand that they may need to adjust their business model and agreement terms to reflect the business and operational realities of the non-traditional franchisee and the venues in which they operate.

Regardless of whether the franchisor is new to non-traditional development or has already gained experience with successful non-traditional operations, the following key practice tips remain constant:

1. Gain internal alignment to pursue the opportunity, understanding it will likely require trade-offs.
2. Define the core pillars of the brand. Know the brand's non-negotiables.
3. Understand who the franchisor is negotiating with. Non-traditional counterparties are unique in terms of leverage, sophistication, and operational complexity.
4. Be prepared for flexibility. Pursuit of coveted non-traditional locations may require adjustments to the contract or operations, even for brands that do not typically negotiate with counterparties.

VII. CONCLUSION

There is more competition than ever for flagship non-traditional locations. In addition to national, regional, and emerging brands, there are many local brands vying to get into the same real estate. Knowing the rules of engagement, understanding the success metrics of the different channels, determining the brand's non-negotiables, and adopting the practice pointers described above will help brands enter and thrive in non-traditional locations.

Author Biographies

Brittany Johnson

Brittany Johnson is Special Counsel at Miller Nash LLP in Seattle, Washington. Prior to joining the firm, Brittany served as in-house counsel for Starbucks Coffee Company for nearly twelve years, leading licensing (franchise) matters throughout the world. She is a frequent writer and speaker on franchise industry matters, past leader of the American Bar Association Forum on Franchising (“ABA Forum”) Young Lawyers Division, and a recipient of the ABA Forum Future Leader Award.

Gina N. Malandrino

Gina Malandrino is a partner at Cheng Cohen LLC in Chicago, Illinois. She is a general corporate and commercial transactions attorney who concentrates her practice on franchise and distribution law, commercial contracts and transactions, private equity financing, mergers and acquisitions, and general corporate and organizational matters. Gina has experience counseling clients on regulatory and compliance issues, negotiating commercial business relationships, rebranding existing franchise systems, establishing joint venture relationships, expanding domestically and internationally, and assisting non-U.S. based franchisors expanding into the U.S. market. She represents a broad range of franchise companies, from emerging brands to mature brands, in various industries including hospitality, restaurants, pet care, fitness, motor fuel, and convenience stores. She assists franchisors of emerging brands in navigating the complexities of developing a franchise program. She also provides ongoing support and assistance to franchisors through all phases of development and operation with everyday business and operations matters they encounter.

Abigail (“Abby”) Whetstone

Abigail Whetstone is the owner and principal consultant of Non Trad Consulting Group, LLC (“NTC”) in Holland, MI. She specializes in connecting emerging, regional and national restaurant brands with non-traditional growth opportunities in venues nationwide. Prior to founding NTC in 2017, Abby held the position of Director of Brands & Concepts at SSP America, a leading operator of airport food and beverage concessions in the U.S. Prior to joining SSP America, she was with Qdoba Restaurant Corporation for over 12 years, most recently as the Director of Non-Traditional Development for it and its parent, Jack in the Box Inc. She was responsible for sourcing and securing non-traditional development opportunities in airports, campuses, hospitals, casinos, travel plazas, malls, kiosks, military installations and more. She holds an MBA in Business Administration and a BS in Organization Management from the University of Colorado. She served two consecutive three-year terms on the IFA National Women's Franchise Committee which is dedicated to inspiring and encouraging women in franchising.

Exhibit A
Sample Franchise Exemption Acknowledgement

Name of Prospective Franchisee: _____ (“Franchisee”)

Name of all Owners (collectively, the “Owners”) of Franchisee:

Owner Name	Residential and Email Address	Percentage Ownership Interest

Read each of the acknowledgment statements written below and initial each one that applies:

___ Franchisee acknowledges, and represents and warrants to [franchisor] (“Franchisor”), that:

1. Franchisee, or any of Franchisee’s current directors or officers, or any current directors or officers of a parent or affiliate of Franchisee, has more than two years of experience in the same type of business; **and**
2. Franchisee has a reasonable basis to anticipate the sales arising from Franchisee’s relationship with Franchisor will not exceed 20% of Franchisee’s total dollar volume in sales during the first year of operation.

___ Franchisee acknowledges, and represents and warrants to Franchisor, that:

1. Franchisee (or its parent or any affiliates) is an entity that has been in business for at least five years; **and**
2. Franchisee (or its parent or any affiliates) has a net worth of at least \$7,348,000.

___ Franchisee acknowledges, and represents and warrants to Franchisor, that:

1. The franchise sale is for more than \$1,469,600 – excluding the cost of unimproved land and any financing received from the franchisor or an affiliate – and thus is exempted from the Federal Trade Commission’s Franchise Rule disclosure requirements, pursuant to 16 CFR 436.8(a)(5)(i); **and**
2. At least one individual in Franchisee’s ownership group will invest more than \$1,469,600 in the franchise purchase (excluding any financing received from the franchisor or an affiliate and excluding the cost of unimproved land).

By signing below, I verify that I have read the statements above and agree with each statement I initialed. I understand that Franchisor is relying on this acknowledgment to determine whether an exemption from the Federal Trade Commission's Franchise Rule disclosure requirements apply.

FRANCHISEE:

[*Insert Name*], a [*Insert entity type and state of formation*]

By: _____

Name: _____

Its: _____

Date: _____

OWNERS:

[*Insert Name*], an individual

Sign: _____

Date: _____

[*Insert Name*], an individual

Sign: _____

Date: _____

[*Insert Name*], an individual

Sign: _____

Date: _____