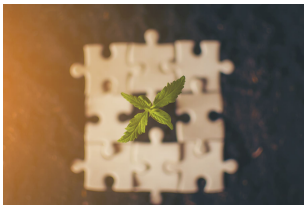

Hemp-chising – Why Hemp Companies Should Consider Franchising?

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Hemp Legally Speaking

Franchising is not an industry. It is a distribution model that can be utilized within any industry – food and beverage, health and wellness, real estate, insurance, education, apparel, technology services, and now hemp.

While franchising is highly regulated and could increase the company's administrative burdens[1], this distribution model may prove to be a viable option for hemp companies. This observation is especially true for hemp companies that (a) are looking to expand rapidly, (b) are unable to self-fund their expansion, and (c) employ third-party dealers, distributors, resellers, and suppliers to offer or sell their products and services to customers or other end-users ("Third-Party Sellers").

From a business standpoint, franchising, among other things,

- allows a company to grow its business with less contingent liability,[2]
- through its agreements incentivizes franchisees to increase the company's revenues and profitability,
- affords the company with substantial latitude to develop fee structures to increase the company's brand revenue as well as impose requisite standards and controls to protect the company's brand, goodwill, and intellectual property,
- helps to systematize the company's operational processes and procedures by developing procedures for each material business activity and train others on how to perform these activities, and
- does not restrict the company from operating corporate units as well. This gives companies the chance to analyze the costs/benefits between operating an additional site themselves or granting its franchisees with a license to operate at such site.

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From a legal standpoint, franchising, unexpectedly, can be used as an effective risk mitigation strategy.[3]

Companies with Third-Party Sellers that operate in multiple jurisdictions must perform time-consuming and expensive legal gymnastics under both federal and state laws to structure their business arrangements to avoid franchising and business opportunity laws ("Distribution Laws"). The broad scope of Distribution Laws and the various ways in which they (a) define a franchise and business opportunity or (b) provide franchise and business opportunity exemptions, make it extremely difficult, if not impossible, to avoid Distribution Laws without having a legal compliant franchise disclosure and registration program ("Franchise Program").

If the company is unable to avoid the application of Distribution Laws, then it must satisfy these laws including their disclosure and registration requirements. In particular, hemp companies may be required to satisfy hemp-specific registrations requirements as a distributor of certain hemp products. Distributor and product registration are not required in every state but are part of a growing trend.

Failure to comply with Distribution Laws subjects the company *and* its owners and directors (in multiple jurisdictions) to federal and state regulatory actions, criminal penalties, and private rights of actions brought by franchisees for violations of Distribution Laws and state unfair trade and practices laws. Additionally, failure to properly register hemp products and also as a hemp product distributor can result in penalties and even impact a company's ability to obtain proper registrations going forward.

To reduce the associated risk of knowingly or inadvertently violating any Distribution Laws, hemp companies should consider franchising and creating a Franchise Program. This may be a prudent decision since a Franchise Program:

- will satisfy federal and state franchise laws and exempt the company from business opportunity laws at the federal level and in many states, and

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- can be a valuable tool to defend against potential misrepresentation and fraud claims brought by franchisees.

Given the potential business and risk mitigation benefits of franchising, hemp companies should take a closer look at incorporating franchising within their business models.

As always, we at Frost Brown Todd are here to help you.

Carlos White has substantial experience in representing companies on franchising and distribution matters. Carlos has structured numerous franchise programs and compliant, non-franchise arrangements for clients in various industries. For more information on this topic, please feel free to contact Carlos White at cwhite@fbtlaw.com.

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[1] Please see our previous blog, "Avoiding The Franchise & Business Opportunity Law Traps" https://fbtgibbons.com/avoiding-the-franchise-business-opportunity-law-traps/.

[2] Typically, the franchisee instead of the company will be responsible for hiring employees, securing the lease, building-out and equipping the site, and other related fixed and operating expenses.

[3] Many companies do not realize how easy it is to fall within the confines of Distribution Laws. For example, requiring a Third-Party Seller to make minimum purchase requirements or charging a Third-Party Seller common fees like training, administrative, set-up, support , and advertising and marketing fees could easily trap a company within the scope of multiple Distribution Laws.

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