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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Dealmakers Q&A: Baker Donelson's Joel Buckberg

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Joel Buckberg

Joel Buckberg is a shareholder in Baker Donelson Bearman Caldwell & Berkowitz PC's Nashville, Tennessee, office, where he is a member of the corporate/mergers and acquisitions group and the head of the firm's franchise and hospitality group. Buckberg counsels clients on business transactions and operations, particularly in hospitality, franchises and distribution, including strategic planning, development, disclosure, equity and debt financing, mergers and acquisitions, system policy and practice development, regulatory compliance, and commercial contracts.

He served for four years as administrator for the International Franchise Association's Franchise Compliance Training Program and is currently a legal adviser and trainer for IFA's Fran-Guard compliance and business culture training program. Prior to joining Baker Donelson, Buckberg was executive vice president and deputy general counsel of Cendant Corp.

As a participant in Law360's Q&A series with dealmaking movers and shakers, Joel Buckberg shared his perspective on five questions:

Q: What's the most challenging deal you've worked on, and why?

A: We closed a small transaction that involved family members in disagreement over the future of the business. The combination of emotional and financial issues, and sometimes unpredictable reactions to seemingly ordinary business propositions, was a challenge to overcome. In this transaction, every nickel and every point was important to someone. In any transaction involving the transition of a franchised or closely held business to a higher level of management sophistication or outsider investment and accountability, emotional components affect the business and legal issues. Pure business deals have some emotional content, but cold logic usually prevails. In this case, heat replaced cold logic, and the twists and turns made each meeting a roller coaster ride.

Q: What aspects of regulation affecting your practice are in need of reform, and why?

A: Franchising regulation evolves slowly and unevenly. The 2007 Federal Trade Commission Franchise Rule changes have yet to be fully harmonized by the states with franchise laws and regulations. The lack of harmony leads to paradoxes where a franchise is available in one state but not in its neighboring state. Regulators routinely have unpublished principles and guidelines that are more reactive to anecdotal events than market issues. Administrative procedures acts are routinely ignored at the state level, but such practices have gone largely unchallenged. Rule-making is needed to give these principles the appropriate scrutiny, public comment and judicial oversight.

The advancement of electronic filing for disclosure documents and related materials is glacial in its pace. All industry constituents and participants would benefit from migration to electronic filing and wider electronic data base availability.

The FTC has been silent on many evolving issues, when its attention and guidance would be useful to expand and clarify safe harbors for disclosure. Interpretive opinions of the FTC Franchise Rule provide guidance to their recipients and to the industry, but this practice seems to have been eliminated from the FTC operations manual. The compliance guide and FAQs are helpful but not necessarily dispositive.

California and other states are considering legislation to reverse judicial victories for franchisors, in attempts to respond to particular circumstances and overgeneralize from fact-specific circumstances that produced a bad result for the franchisee. Any such victory will be Pyrrhic, as franchisors will sell securities or resort to management agreement transactions if franchising presents too much legal risk. That said, cavalier franchisor management that pushes system and business plan changes without regard for the financial and operational impact on franchisees invite legislative or regulatory responses. Franchisor managers call the relationship a "partnership," which is not true in the purely legal sense. Franchisors and franchisees share risk, just not the same risk.

A system change promulgated by the franchisor can damage or kill the franchise system, which affects not only the franchisor's equity holders but all of the franchisees' equity holders. Franchisees and their equity holders have no vote, in most cases, on these changes and on the management of the franchisor. This places a higher burden of responsibility on the boards of franchisors to select managers who recognize the relationship dynamics of a successful franchise system, and who will be good brand stewards for their own entities as well as franchisees. So the regulatory challenge for the franchise world is as much internal as governmental.

Q: What upcoming trends or under-the-radar areas of deal activity do you anticipate, and why?

A: As private equity invests in both franchisor and franchisee transactions, the liquidity of franchisee ownership may improve. Franchisors must be responsive to more educated and sophisticated franchisee owners, who are now as likely to be financial buyers as strategic or personal business buyers. De novo franchises will populate narrow market niches, then struggle to appeal to a broader audience as interest in a narrow product line wanes. I see more strategic affiliations and multibrand units, much as Red Mango yogurt has recently expanded their offerings.

The International Franchise Association published after much study a set of guiding principles, followed by a task force white paper on franchise support. The deal activity in the franchise space is likely to follow franchisors who embrace these formulas for business success and achieve better franchisor/franchisee stability and system growth. I also predict that franchisors appealing to a younger demographic will focus on better execution of social media platforms, to the exclusion of traditional marketing media. The attractive candidates for acquisition will be built in part on smart use of social media at the brand and store level, rather than traditional platforms and brand commercials.
The business model of growth through area developers/representatives that promote the building out

of a system in exchange for a share of initial and ongoing fees is likely to morph into something else. These are people who used to work for corporate America, and have been downsized, right-sized and laid off into working for themselves but not by themselves. It's unclear whether this model is sustainable in the long term.

One frightening risk that affects franchising is the prospect of success by the Department of Labor in characterizing the franchisor and franchisee as joint employers of the franchisee's employees. The related risk is the trend in Seattle, Chicago and elsewhere seeking to push higher minimum wages on franchise systems, regardless of the legally recognized employer. These efforts are joined philosophically in the income inequality pantheon to push legislated social policies on economic free markets. Both will result in constrained franchise growth, and produce as the most likely consequence the end of franchise opportunity for middle-class Americans. Brands will go back to selling securities instead, because they cannot accept uncontrollable business risks.

Q: What advice would you give an aspiring dealmaker?

A: Focus on higher growth potential systems with strong management teams that have scalable growth platforms. Plan for a coherent geographic growth strategy, and avoid opportunistic, reactive approaches that will overmatch marketing resources and supply chain benefits from store concentration. Niche players have a short shelf life, so unless the product line is expandable and the management team capable of sustaining a product or service line expansion, be wary. I think consumers and businesses will look to fewer service providers providing a broader range of services competently and efficiently.

Q: Outside your firm, name a dealmaker who has impressed you, and tell us why.

A: David Kaufmann, who recognizes value and understands how brands need to be positioned to grow. He works with many private equity owned brands to restructure their programs and help them understand the hidden elements and opportunities associated with each purchase.

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