

# Starstruck and Star-Stricken: When Celebrities Buy and Sell Franchises

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For entertainers like Jimmy Buffet, Samuel L. Jackson, Gene Simmons, Kanye West, Drake, and Rick Ross, and athletes like Hank Aaron, Magic Johnson, Peyton Manning, Michael Strahan, Emmitt Smith, Drew Brees, LeBron James, Russell Westbrook, Phil Mickelson, Venus Williams, and Dak Prescott, franchise ownership is an alluring investment. Franchises provide celebrities looking to diversify their portfolios and build lasting wealth with a potentially stable income stream and reliable hedge against market swings. Some franchised businesses call on the celebrity to do as little or as much in operating or associating with the business as desired. Along with song royalties, residuals, and pension benefits, a stake in a franchised business can support a celebrity long after their public career ends and fame has faded.

For franchisors, investment from a celebrity brings possibilities for attracting more customers and franchisees based on the celebrity's fame. While the promise of celebrity endorsement can boost the franchise brand and image, the franchisor must weigh the possible benefits against potential risks, like whether the celebrity investor will resist changes to the system, has a checkered financial history, is difficult to work with, or may bring bad publicity. As an example of the latter risk, O.J. Simpson was, at one time, a prominent spokesperson for Hertz Car Rental and Honey Baked Ham.

Negotiating franchise and development agreements with or for a celebrity can be more challenging than negotiating with or for a sophisticated or experienced multi-unit franchisee. An understanding of the points of tension in franchise relationships with celebrities helps in

representing a franchisor dealing with a celebrity or representing a famous client seeking to buy or sell a franchise.

## Representing the Rich and Famous

Counsel for a public figure may be surprised to learn that they will have little and possibly no direct communication with the client. More likely, they will report to and confer with business managers, agents, accountants, other attorneys, and other representatives of the public figure. These representatives may have their own associates or relatives involved, and sometimes their own agendas, such as pride in the celebrity connection or fear that the client will come to prefer another advisor (i.e., counsel). The franchise lawyer must navigate the many voices in the client's ears and give truthful and accurate legal advice to the client—whomever that may be—relating to starting or investing in a franchised business. It is important to avoid giving legal advice counsel believes the representative or celebrity simply wants to hear or being awed and overwhelmed by the client's talent or fame.

## Disclosure Considerations

One factor to consider in representing a franchisor wanting to sell a franchise to a celebrity or a celebrity wanting to purchase a franchise is whether the disclosure is required or prudent if not required. A well-compensated professional athlete or famous entertainer may maintain a high net worth. The Federal Trade Commission ("FTC") Franchise Rule and certain registration states exempt franchisors from disclosure obligations to high-net-worth individuals.



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For example, under the FTC Rule's Large Franchisee Exemption, a franchisor is exempt from making disclosures to a prospective franchisee that is an entity with a net worth of at least \$6,165,500 and has been in any business for at least five years. 16 C.F.R. § 436.8(a)(5)(ii). By way of further example, California's Franchise Investment Law exempts from disclosure obligations franchisee entities with assets over \$5,000,000 and individual franchisees with a net worth over \$1,000,000 or a gross income exceeding \$300,000 (or \$500,000 with a spouse) in each of the two most recent years. The net worth and gross income of a celebrity's other investment partner(s) may need to meet these thresholds as well. Furthermore, the initial investment cannot exceed 10 percent of any investor's net worth or joint net worth with a spouse, exclusive of certain assets. See Cal. Corp. Code § 31109. The 10 percent requirement can be significant, as it is common for celebrities to commit to multiple units or invest with individuals who do not meet the net worth requirements.

These disclosure exemptions may not always apply. Even where they do, there can be sound reasons to undertake disclosure, including for the sake of transparency to start the franchise relationship on good footing.

### Due Diligence

Whether or not a franchisor provides a Franchise Disclosure Document ("FDD"), the celebrity client or agent or business manager is unlikely to be spending their time reviewing it or conferring with other franchisees and multi-unit operators identified in Item 20, as prospects are often advised to do. The onus is on franchise counsel for the celebrity to do as much diligence as possible. That diligence should include securing and reviewing a disclosure document from the franchisor or publicly accessible sources. Existing franchise agreements, when attainable, can be compared to the franchisor's standard agreement in the FDD to discover whether the franchisor entered into special arrangements with one or more franchisees, such as a reduced royalty or a right of first refusal when new or additional franchises are available in a neighboring area. Similar to free agency in professional sports, the celebrity franchisee will want to know if another celebrity passed on the brand for other franchise opportunities or received a sweeter deal than the current celebrity.

The franchisor must do diligence as well. That diligence should include evaluating the qualifications and business acumen of the celebrity

and his or her management team. When the celebrity franchisee's role is solely that of full or majority financier, the franchisor often settles for training and interfacing with members of the celebrity's management team. That team may consist of atypical franchise operators in the celebrity's inner circle, such as a childhood friend, relative, personal confidant, or another close advisor with less independent wealth or ownership interest in the franchised business. The franchisor must ensure the designated person is qualified to operate the business and sufficiently invested in the business's success before approving them as the celebrity's point person.

### Reviewing and Negotiating Common Terms

A franchisee celebrity's level of involvement in a franchise relationship will vary. They may be interested in simply receiving a portion of topline revenues from one or more outlets. Or a superstar could join forces with a franchisor and its management, become the brand ambassador, and sit on the board of directors, like Shaquille O'Neal and his relationship with Papa Johns.

In either of these scenarios, the franchisor might make concessions for the celebrity franchisee to get the deal done. When a celebrity franchisee plans for hands-off participation, the ideology of a typical franchise relationship—imposing duties to develop units and devote full time and best efforts to their operations—is turned on its head. Examples of terms where concessions may be considered include the following:

- **Initial and Ongoing Fees:** Many franchise agreements require initial fees to cover costs of training, site selection and buildout, initial inventory, grand opening marketing, and other services. Ongoing fees in the form of, for example, royalties on revenues and advertising and marketing fees are also required. If the franchisor wishes to use a public figure's name and likeness to promote the brand, a waiver or reduction of initial fees, royalties, and/or marketing-related fees and expenditures, such as local advertising spends and marketing fund and cooperative contributions, may be an appropriate tradeoff. The celebrity can bring the value of licensed content and intellectual property (i.e., videos, film portrayals, and photos) to advertise and promote the franchisor's products or services. In some cases, the celebrity's

involvement is the grand opening marketing for his or her outlet.

- **Use of Name, Image, and Likeness:** Occasionally, a franchisor may use still images and videos of franchisees, franchised locations, employees in uniform, and products sold or services performed as sources for advertising the brand to the public and for selling franchise opportunities. The franchise agreement sometimes lets the franchisor take and use photos and videos of these elements without franchisee authorization or compensation. A celebrity franchisee has an interest in limiting the franchisor's usual freedom here. Commercial appropriation of a public person's name, image, likeness, voice, or another aspect of identity can give rise to right of publicity and possibly false endorsement claims. Therefore, a celebrity franchisee may seek the right to give express written consent for the franchisor's use of his or her name, image, or likeness, and only with the celebrity's approval of the image or footage. Work-made-for-hire and copy-right ownership terms in most franchise agreements deem the franchisor the sole owner of creations that improve or are used in the franchise system or grant a royalty-free license. These clauses may need to be modified to protect the celebrity's intellectual property and rights to use their image or likeness.

- **Social Media:** The franchisor and celebrity franchisee may have a mutual interest in coexisting on their respective social media accounts or other promotional channels. The franchisor's social media policy typically provides for ownership of accounts that bear the franchisor's trademark.

These policies need not pose an issue for the celebrity franchisee's use of independent accounts dedicated to the celebrity and not predominately using the franchisor's trademark. The celebrity has an interest in having the franchisor acknowledge ownership rights to his or her independent accounts as separate assets so that the use of the trademark resulting from an announcement or news story about the celebrity's investment in the brand does not result in transfer or assignment of the celebrity's accounts to the franchisor.

- **Training:** Most franchise agreements require the franchisee's principal owner, manager,

or other key personnel to travel to and complete the franchisor's initial training. A celebrity franchisee is less likely to participate directly, especially when he or she has a team of intended persons for day-to-day operations. Counsel for the celebrity may seek, and a franchisor may allow, concessions in the celebrity's training obligations. For example, the training may take place at a location other than the contractually contemplated location, or someone other than the celebrity, such as a business manager, may be permitted to attend some or all portions of the training on the celebrity's behalf.

- **Non-Competition:** Public figures may already have various business interests when they sign a franchise agreement. For example, in addition to his Papa Johns interests, Shaquille O'Neal also owns the Big Chicken fast-casual brand and has owned Krispy Kreme and Five Guys franchises. See <https://www.businesswire.com/news/home/20190322005197/en>. In this context, the definition of a "competitive business" may be important to both sides, and attention should be paid to what kind of additional business interests the franchisor and franchisee can and cannot have under the parties' agreement. For example, if the celebrity's team has experience operating KFC restaurants and wants to invest in a different restaurant system like Burger King or Panera that includes fried chicken sandwiches as one of many menu items, the parties may accomplish compromise with reasonable limits, like a 10 or 20 percent cap on the franchisee's gross revenues from the sale of potentially competitive items in the other business.
- **Personal Guaranty, Security Agreement, and Cross-Default:** Many structures of the personal guarantee are possible, even if the franchisee is not famous. For example, guarantees can have maximum liability limits palatable to the celebrity's investment and net worth. A franchisor may be unwilling to dispense with or narrow the personal guaranty until after, for example, the celebrity has opened a third or fourth unit. Limits on the amount or duration of the guaranty are often on the table and may be capped for all owners of the franchised business. Separately, expect cross-default, cross-collateralization, and related provisions that invoke rights

to security interests in the celebrity's personal assets to be areas of hard negotiation. The franchisor may wish to preserve the right to default or terminate if the franchisee breaches a morals clause in an endorsement or other personal services agreement.

- **List of Former Franchisees and Confidentiality:** A franchisor must disclose the name, city, state, and current business telephone number, or, if unknown, the last known home telephone number, of every franchisee who had an outlet terminated, canceled, not renewed, or otherwise ceased to do business under the franchise agreement during the most recently completed fiscal year. See 16 C.F.R. § 436.5(t)(5). Rarely will a celebrity want to have a home or cell phone number disclosed after leaving the system. Fortunately, a footnote to this rule permits franchisors to substitute alternative contact information at the former franchisee's request. *Id.* at n.10. The celebrity can select an appropriate option, like a post office box or other managed email account.

### Selling Franchises—FDD Item 18

The use of celebrities to promote franchise brands is nothing new. Arthur Murray was already a well-known dancer when his franchised dance studios began to expand throughout the United States. Other stars who lent their names to franchises include Mickey Mantle, Joe Namath, Dizzy Dean, Johnny Carson, Minnie Pearl, and Roy Rogers. See *Franchising Business Opportunity Ventures; Disclosure Requirements and Prohibitions*, 43 Fed. Reg. 59,677 n.402 (Dec. 21, 1978). When it was promulgated, the Statement of Basis and Purpose for the FTC Franchise Rule evinced a concern of “flagrant abuses [in] the use of celebrities in sports and entertainment fields to head up franchises, inducing sales of franchises solely on the basis of the big name and little else.” See *Id.* at 59,677. Modern examples such as Kenny Rogers Roasters, Jimmy Buffet's Margaritaville, Wahlburgers, and Mayweather Boxing + Fitness illustrate how celebrities continue to use “big name” allure to launch their own franchise brands.

To address some of its concerns, the FTC Rule dedicated a specific disclosure requirement in Item 18 for public figures helping to sell franchise opportunities. Although Item 18 is seldom invoked today, it remains part of the Rule because famous names carry significant marketing power in offering and selling franchises. Item 18 provides prospective franchisees transparent

details on how and the extent to which a public figure used to promote a brand is actually involved in the brand.

Under Item 18, a franchisor must disclose “[a]ny compensation or other benefit given or promised to a public figure arising from either the use of the public figure in the franchise name or symbol, or the public figure's endorsement or recommendation of the franchise to prospective franchisees.” A franchisor must also disclose the public figure's involvement in the management or control of the franchisor, including positions and duties in the franchisor's business structure, and the amount and type of investment the public figure has in the franchisor, including cash, stock, promissory notes, and any in-kind services performed by the public figure. A public figure is defined as “a person whose name or physical appearance is generally known to the public in the geographic area where the franchise will be located.” 16 C.F.R. § 436.5(r)(1)-(4).

For an example of each disclosure requirement, Item 18 of Papa John's 2022 FDD discloses the compensation that Shaquille O'Neal receives for personal services as brand ambassador, his co-ownership stake in nine company-owned restaurants as a joint venture with the franchisor, the amount of his capital contribution, and his appointment to the Papa John's board of directors. Since O'Neal holds a management position as a director, Item 2 of Papa John's FDD also discloses details about his experience and work history.

Item 18 limits its reach to a public figure's identification with a system to help sell franchises. Using a public figure as a spokesperson to promote the brand's products or services does not bring a franchisor within the ambit of Item 18. See *FTC Franchise Compliance Guidelines* (May 2008), p. 84. Franchisors need not disclose compensation for ordinary endorsement agreements, appearances in commercials, or other use of a person's likeness to promote the services or products of the brand. Nor must Item 18 disclose a celebrity's investment if that celebrity will not assist in franchise sales.

### Conclusion

Unique issues arise when a famous person takes a serious interest in a franchisor's brand and products. They call on franchise practitioners on each side to understand areas of the franchise relationship that may warrant modification, as well as unique disclosure obligations and considerations. Adept handling of the transaction and representation will make you a star to your clients. ■