

Burgers, Fries ... and Botox? Franchising a Health Care Provider

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Overview of Presentation

- Agenda
 - Background on franchising as a business model
 - What is a franchise and what are the legal implications?
 - Advantages and disadvantages of franchising
 - Health law issues that affect franchises
 - Franchising issues that affect health care providers
 - Business models and agreements
 - Key franchise structural arrangements
 - Health franchise relationships

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BACKGROUND ON FRANCHISING

Franchising in the United States

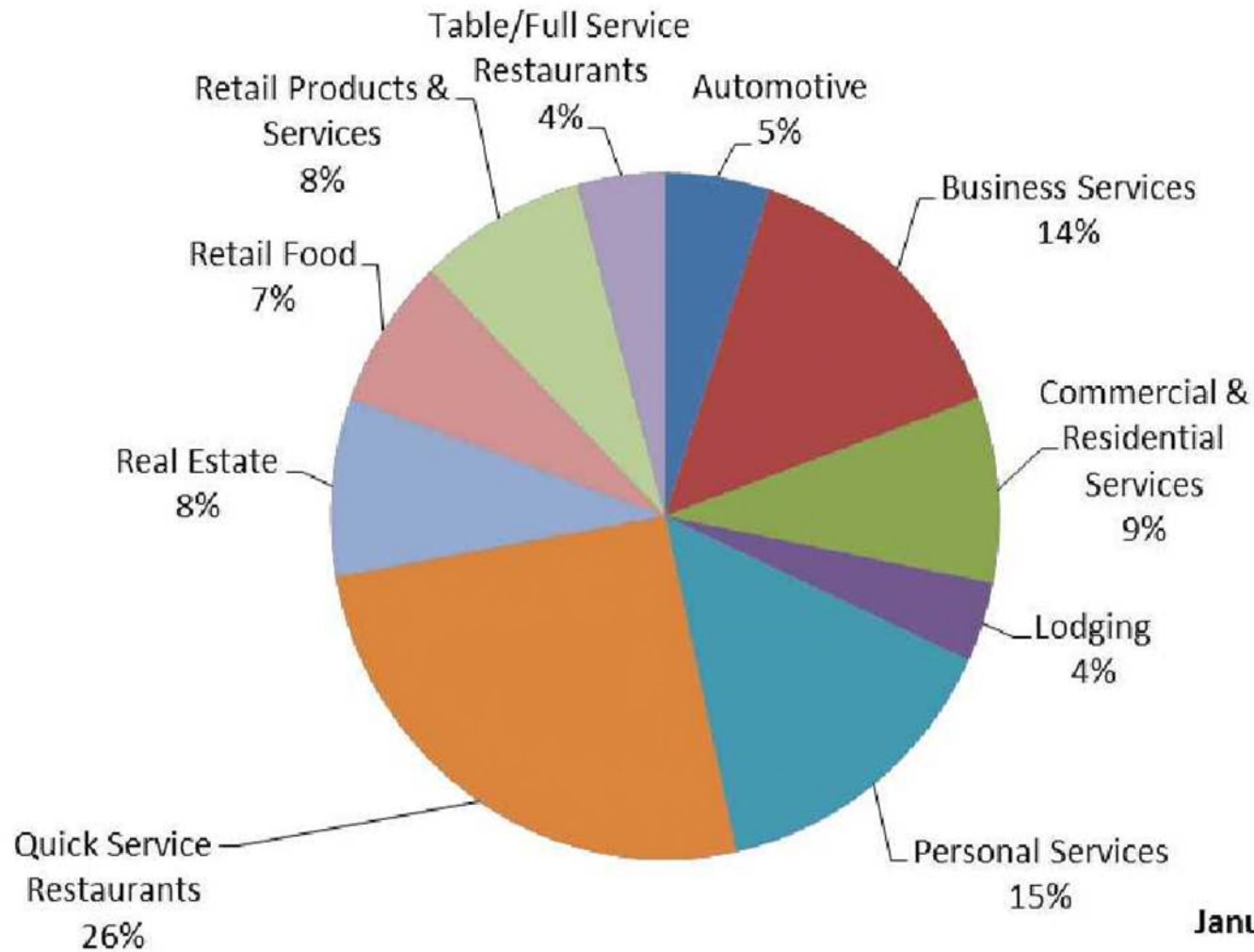
- The growth of franchising:
 - Where did it come from?
 - The status of franchising today
- Franchising in health care:
 - Product based systems
 - Rise of senior care (home health, non-medical home care)
 - Medical (travel clinics, travelling clinicians, primary care, pediatrics)
 - Other health (chiropractic, balance, massage, mobility, diet & nutrition)
 - Ancillary services (lab, PT, eye, ear, feet, staffing)
 - Creative health franchises (can I get you a drink with that?)
 - Future of health care franchises
- Franchise regulation v. health regulation

Myths of Franchising

- You get a proven system with a franchise
- Franchising provides franchisees with established products or services
- The franchise comes with complete training
- Franchising guarantees market penetration
- Buying a franchised business guarantees success
- Franchising is a form of business ownership
- Franchising is a protective relationship in which the franchisor is looking out for the best interests of the franchisee

* *Some aspects of all of these statements are correct.*

Establishments Distribution by Sector 2017



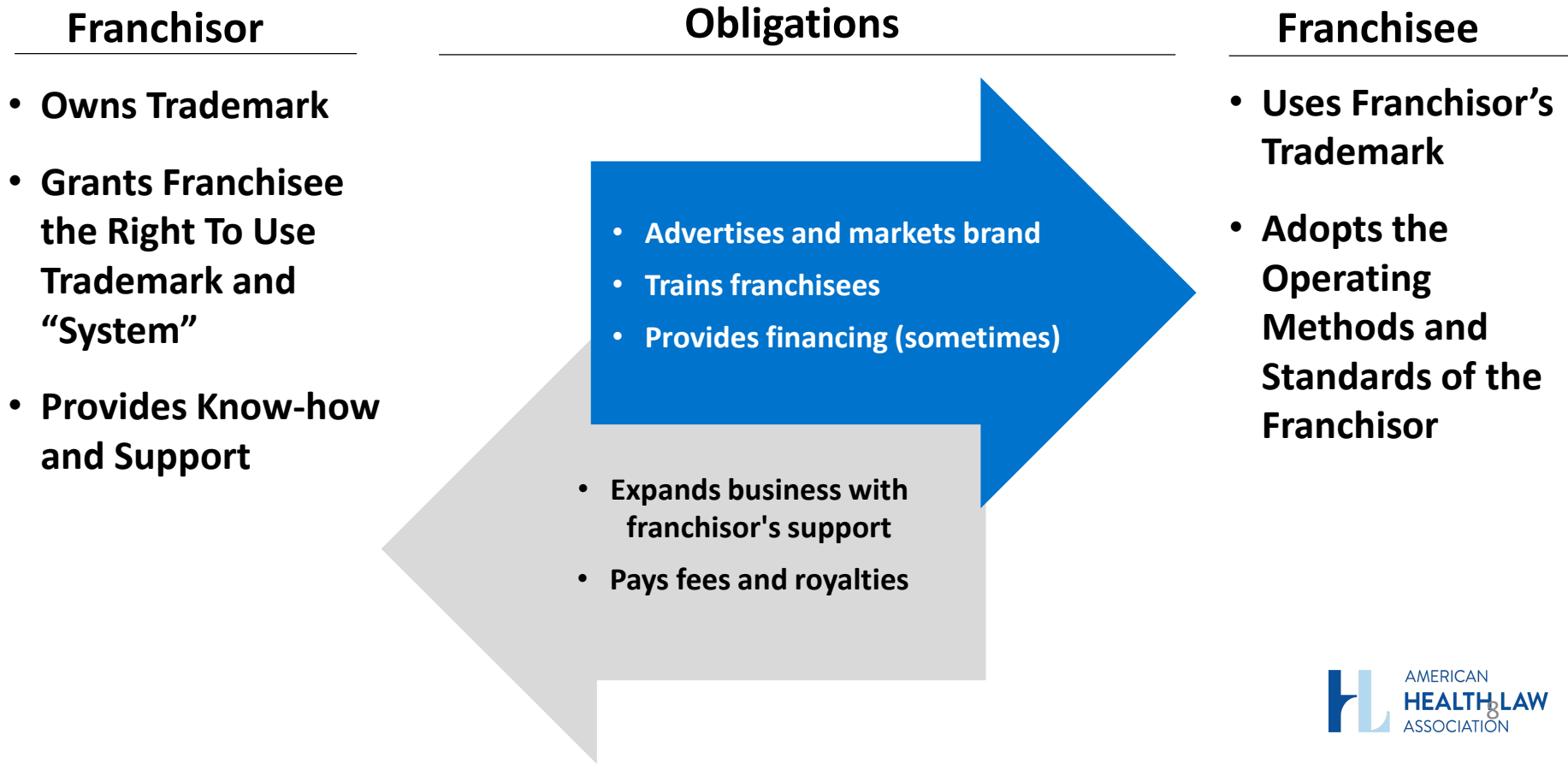
January 2017

What is a “franchise” and what are the legal implications?

- General concept of a “franchise”:
 - Key terminology
- Definition of a “franchise”:
 - Trademark association/license
 - Significant control or assistance
 - Franchise fee or required payment
- Federal and state distinctions:
 - Federal definition
 - State definitions
- Disclosure requirements:
 - The “Franchise Disclosure Document”
 - Registration requirements
- State law obligations

What is Franchising?

- A marketing method and an expansion model
- Business Format and Product Distribution franchises



Why Operate as a Franchise?

- Advantages of model:
 - For franchisors:
 - Brand expansion
 - Franchisees as owners creates profit motive
 - Germinator of new ideas
 - For franchisees:
 - In business for yourself, but not by yourself
 - Brand recognition = stepping-stone for growth
 - Largely built-in customer base

Why Operate as a Franchise?

- Disadvantages of model:
 - For franchisors:
 - “Bad” franchisees can torpedo the whole system
 - Challenge of letting go, particularly where health care requirements drive franchise standards
 - For franchisees:
 - Not totally independent
 - Ongoing financial obligations
 - Creature of contract law

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KEY HEALTH CARE ISSUES

Key Health Care Issues for Franchise Systems

- Corporate practice of medicine
- Business organization laws
- Licensure and scope of practice
- Marketing and advertising
- Anti-kickback Statute and Stark Law
- State anti-kickback, “mini” Stark and fee splitting laws
- Privacy and security
- Medicare (and other federal health programs)
- Commercial payor requirements
- Unique Issues associated with particular types of health care franchises

Corporate Practice of “Medicine” Doctrine

- Background on the corporate practice of medicine (“CPM”) doctrine:
 - Where did it come from and why does it exist?
- CPM today:
 - What types of services are covered?
 - Where does it exist?
 - Are there exceptions?
 - Penalties and enforcement
- Implications of the CPM for franchising: typical franchisor control of operations is problematic
 - Implications for franchisor
 - Implications for franchisee
- Solutions: can we avoid this altogether?
- Solutions: franchisee to focus on business issues / function as manager

Options for Organizing the Franchised Business

- General principles of corporate law
- Limitations for health care franchises
- Implications of CPM and professional licensure requirements
- Development of professional firms
- State law professional firm requirements
- Who controls the issue?

Provider & Entity Licensure and Scope of Practice

- State law licensure requirements:
 - Provider licensure
 - Entity licensure
 - “Unlicensed Practice”
- Scope of practice:
 - Physicians
 - Non-physician practitioners
- Collaboration and supervision
- Implications for franchisor
- Implications for franchisee

Licensure and Scope of Practice (continued)

- Implications of “cutting edge” or “novel” franchise ideas or delivery models
- Other potentially applicable requirements:
 - Certification
 - Registration
 - Accreditation
- Franchisor input in structuring care delivery model

Marketing & Advertising

- General approach used in traditional commercial franchises:
 - The importance of the brand
- Advertising and marketing to consumers:
 - National and local advertising
- Funding for marketing activities
- Implications of health law requirements on marketing and advertising

Anti-kickback Statute

- Overview of federal Anti-kickback Statute (“AKS”)
- Penalties
- Safe harbors
- Application of AKS to health franchises:
 - Referrals v....
 - Marketing, recommending or arranging
 - Relationships between referral sources outside of franchise system
 - Joint ventures
 - Relationships with customers
- Strategies for addressing AKS in franchise systems

Stark Law

- Overview of Stark Law and key questions about applicability within franchise system:
 - Designated health services
 - Physician
 - Referral
 - Financial Relationship
 - Entity
- Exceptions
- Penalties
- How Stark Law can apply to franchise systems
- Strategies for addressing Stark Law in franchise systems

State AKS, mini-Stark and fee splitting laws

- Overview of state AKS laws:
 - Medicaid
 - Commercial
 - All payor
 - Exceptions/safe harbors
 - Enforcement
 - Applicability to franchising
- Overview of fee splitting laws:
 - What is it and to whom does it apply?
 - Applicability to franchising
 - Enforcement
- State law “mini” Stark laws
- Strategies for addressing state AKS, mini-Stark and fee splitting laws in franchise systems

Health Care Privacy and Security

- Key HIPAA requirements:
 - Privacy Rule
 - Security Rule
 - Breach Notification Rule
- Application of HIPAA to franchises:
 - Is franchisee a covered entity?
 - What does it mean to be a “health care provider”?
 - Is “health care”, for purposes of HIPAA, being delivered through the franchise system?
 - Covered transactions

Health Care Privacy and Security (continued)

- What is a business associate (and who decides)?
 - Implications for franchisee
 - Implications for franchisor
- Intersection of traditional franchise concepts and HIPAA:
 - Uses and disclosures common in franchising
 - Implications of HIPAA on typical flow of information / expected uses of information within franchise system
 - Organizational options for franchisees and franchisors
 - Subcontractors
 - “Ownership”, “marketing” and “sale” of health information
- State law restrictions:
 - State health privacy laws
 - State security breach laws

To be or not to be: Medicare

- Serving Medicare patients:
 - Advantages
 - Disadvantages
- Implications for franchise system that serves Medicare patients:
 - Enrollment
 - Participation
 - Billing
 - Relying on expertise and guidance of franchisor
 - General regulatory principles for “suppliers” and “providers” that may be at odds with franchise concepts
- Who decides?
- Hybrid models
- Associated risks

To be or not to be (Part 2): Other Govt. and Commercial Payors

- Serving beneficiaries of other government and/or commercial plans:
 - Advantages
 - Disadvantages
- Implications
- Transactional issues well familiar to providers may be news to franchisors
- Who decides?
- Hybrid models

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KEY FRANCHISE ISSUES

Background on Franchising

- Franchises in the U.S. are regulated by:
 - Franchise sales laws
 - Franchise relationship laws
- Franchise sales laws regulate when and how a franchise may be offered and sold
- The Federal Trade Commission Franchising Trade Regulation Rule (“FTC Rule”) is a federal law which applies to all franchises offered and sold for locations in the US
- FTC Rule’s definition of franchising:
 - Trademark license
 - Promise of:
 - Substantial assistance; or
 - Substantial control regarding operation of a business
 - Payment of a fee

What Does the FTC Rule Require of Franchisors?

- At least 14 days before signing an agreement or accepting a payment, the franchisor must deliver to prospective franchisees:
 - Franchise Disclosure Document (“FDD”) including:
 - Standard form of franchise agreement
 - Other standard agreements
 - Audited financial statements
- No documents are filed with the FTC

What Is the Franchise Disclosure Document ?

- The Franchise Disclosure Document (“FDD”) discloses extensive information about the franchisor
- The FDD is intended to provide prospective franchisees sufficient information to make educated decisions about the investment
- Specific items are required to be included in FDD (see next slides)

Items in Franchise Disclosure Document

1. The Franchisor and any Parents, Predecessors and Affiliates
2. Business Experience
3. Litigation
4. Bankruptcy
5. Initial Fees
6. Other Fees
7. Estimated Initial Investment
8. Restrictions on Sources of Products and Services
9. Franchisee's Obligations
10. Financing
11. Franchisor's Assistance, Advertising, Computer Systems, and Training

Items in Franchise Disclosure Document (continued)

12. Territory
13. Trademarks
14. Patents, Copyrights, and Proprietary Information
15. Obligation to Participate in the Actual Operation of the Franchise Business
16. Restrictions on What the Franchisee May Sell
17. Renewal, Termination, Transfer, and Dispute Resolution
18. Public Figures
19. Financial Performance Representations
20. Outlets and Franchisee Information
21. Financial Statements

Other Disclosure Obligations under FTC Rule

- Prospective franchisee must be provided full franchise agreement (ready to sign) at least 7 calendar days before signing
- Franchise Disclosure Document must be updated:
 - whenever information required to be disclosed changes materially;
 - annually within 120 days of the franchisor's fiscal year end

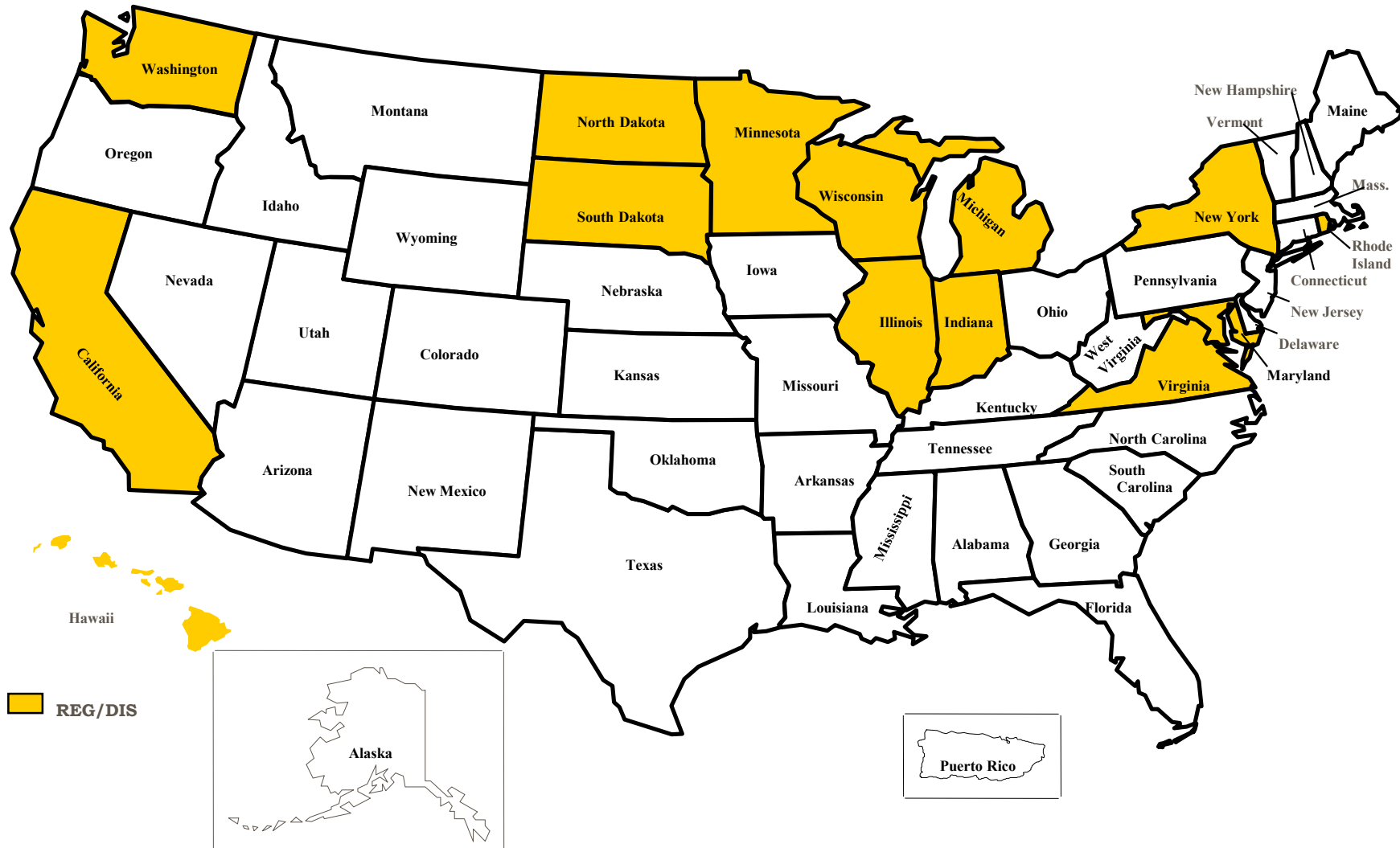
Exemptions to FTC Franchise Sales Rule

- \$1 Million initial investment
 - Includes investment in multiple franchises under: Area Development and Master Franchise Agreements
 - Must come from a single investor
- \$1 Million does not include:
 - Amounts financed by the franchisor and its affiliates.
 - Investments in unimproved real property (“raw land”)
- \$5 Million net worth and 5 years business experience of franchisee, its parent or affiliates

How Do States Regulate Franchises?

- State registration and disclosure laws:
 - Franchise sales laws regulate franchise offers & sales in 14 states
 - Registration required (file FDD and application with state agency)
- State “franchise relationship” (or dealer protection) laws:
 - Origin of, and rationale for, dealer protection
 - Typical requirements of dealer protection laws
- State business opportunity laws:
 - Comparison to franchise requirements
 - Common requirements
 - Enforcement
- Common law prohibitions on fraud / misrepresentation
- State regulators may not understand health care franchises

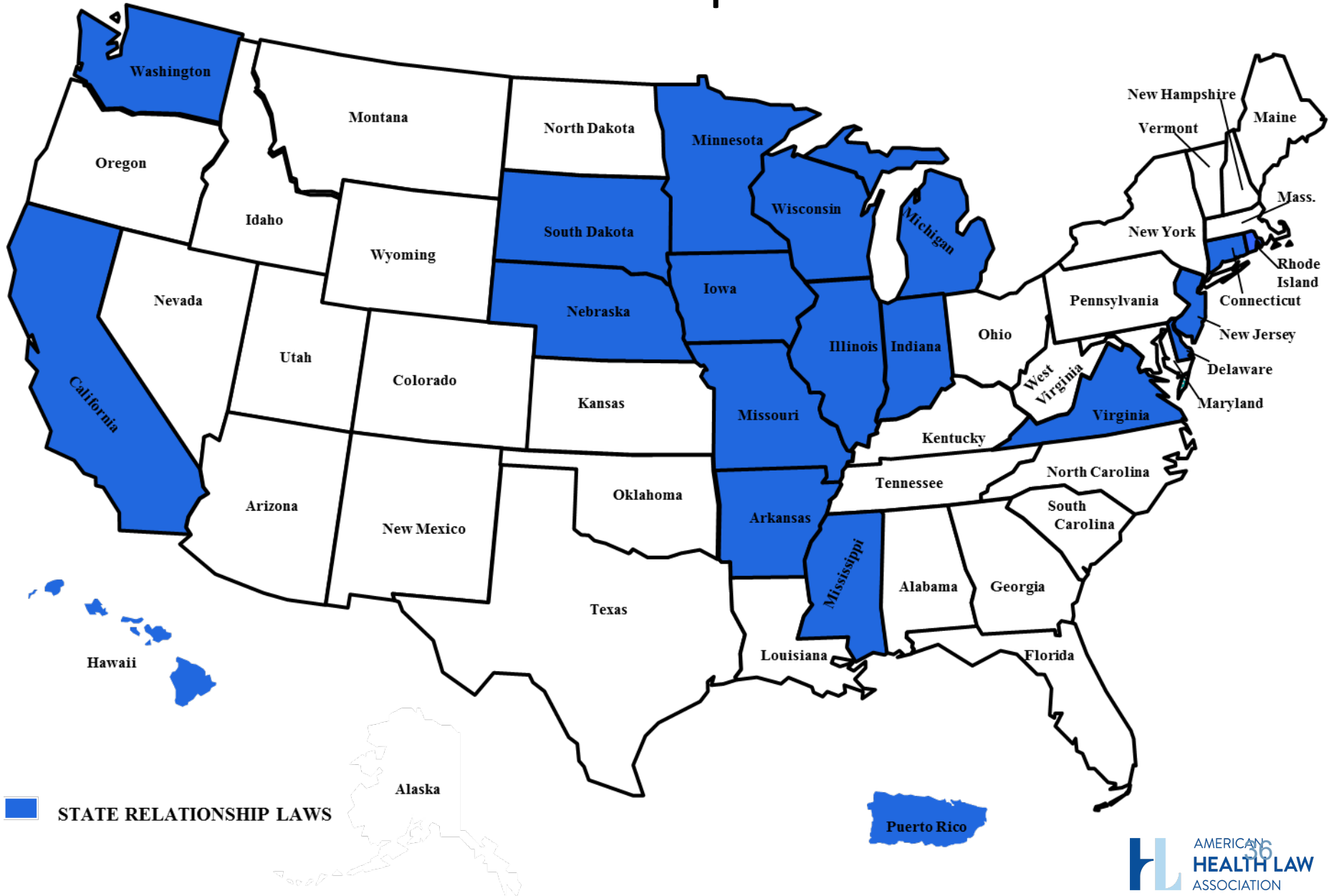
State Franchise Registration and Disclosure Laws



Timing

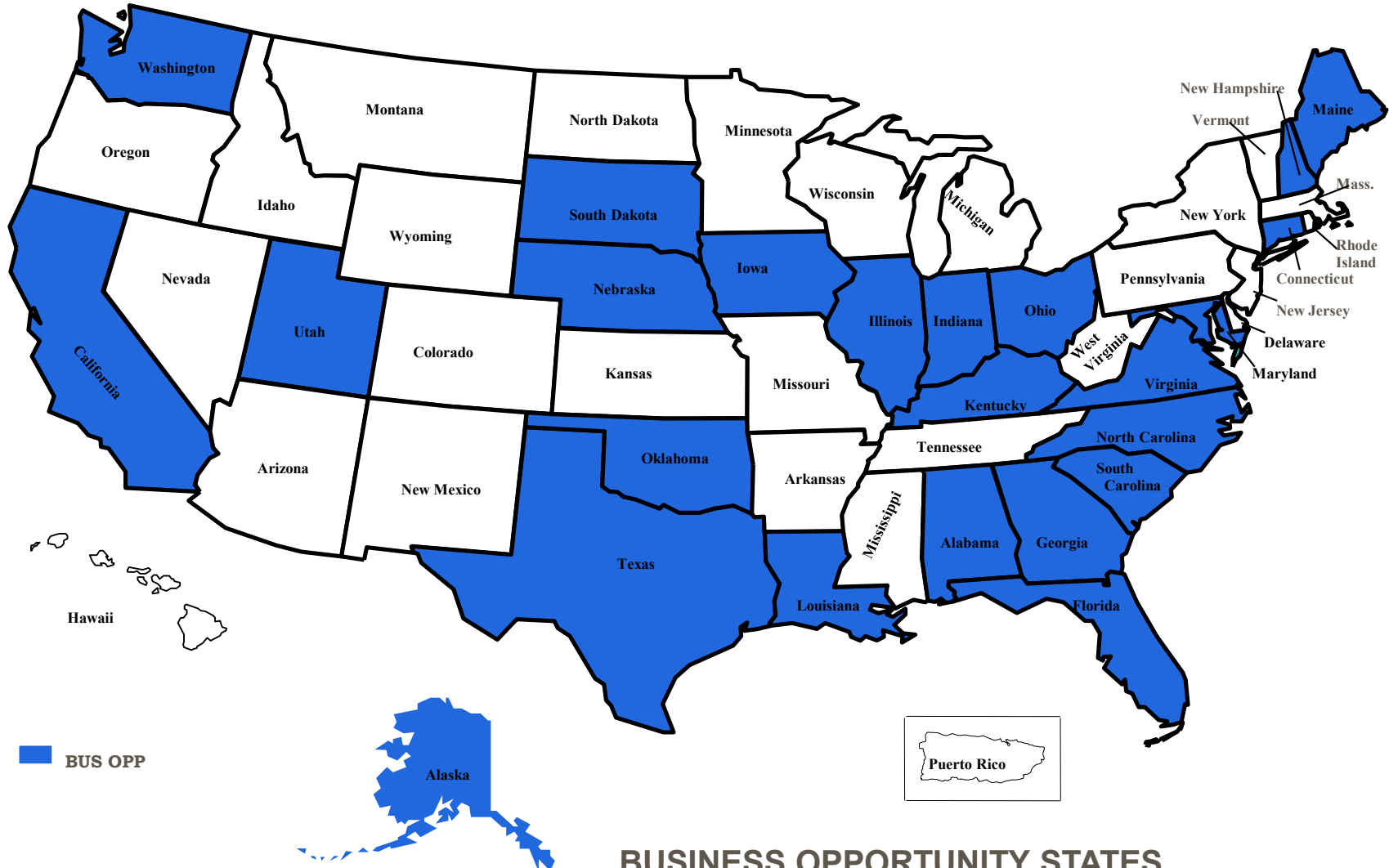
- When must franchise filings be made?
 - Before making an “offer” of a franchise
 - In or from a state with a registration law
 - To a resident of a state with a registration law
 - To one purchasing a franchise to be located in the state (sometimes)
- How long is registration effective?
 - Usually for one calendar year or until 90-120 days after franchisor’s fiscal year end
 - Amendments to registrations are required if a material change occurs to required disclosures

Franchise Relationship Laws



 STATE RELATIONSHIP LAWS

Business Opportunity States



The “Accidental” Franchise

- What is it and how can arise?
 - Trademark
 - Fee
 - Control or assistance
- Why does it matter?
- Other “structures”
 - Licenses
 - Affiliations
- Avoiding the “accidental” franchise
 - Remove one of the three elements of a franchise:
 - Community of interests / control over methods of operation
 - License to trademark
 - Fees paid (territory fee, training fee, excessive inventory, license fees)

Franchisor's Liability for Franchisee

- What is it and how can it arise?
- Risks of vicarious liability
- Addressing issue through control:
 - Franchise agreement
 - Other options
- Implications of key health care laws on traditional franchise principles
- Potential joint employer issues—is a person hired by a franchisee, who works for a franchisee, also an employee of franchisor?

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BUSINESS MODELS AND AGREEMENTS:
Franchise Perspective

Traditional Franchise Arrangements

- The “Franchise Agreement”
- Key principles:
 - Grant clause
 - Territorial Rights
 - Term and renewal
 - Payment and royalties
 - Advertising
 - Trademarks
 - Franchise system standards
 - Termination
 - Obligations upon termination
- Is it negotiable?
- How do health care requirements factor in?

Traditional Franchise Arrangements (continued)

- Franchise operations manual
- More complex arrangements
 - Area development agreement
 - Development agent agreement
 - Master franchise agreement or sub-franchise agreement
- Others?
 - Franchise advisory councils
 - Franchisee associations
 - Communication
- Key franchise business models

Key Franchise Business Models

Unit Franchising

Franchisor grants:

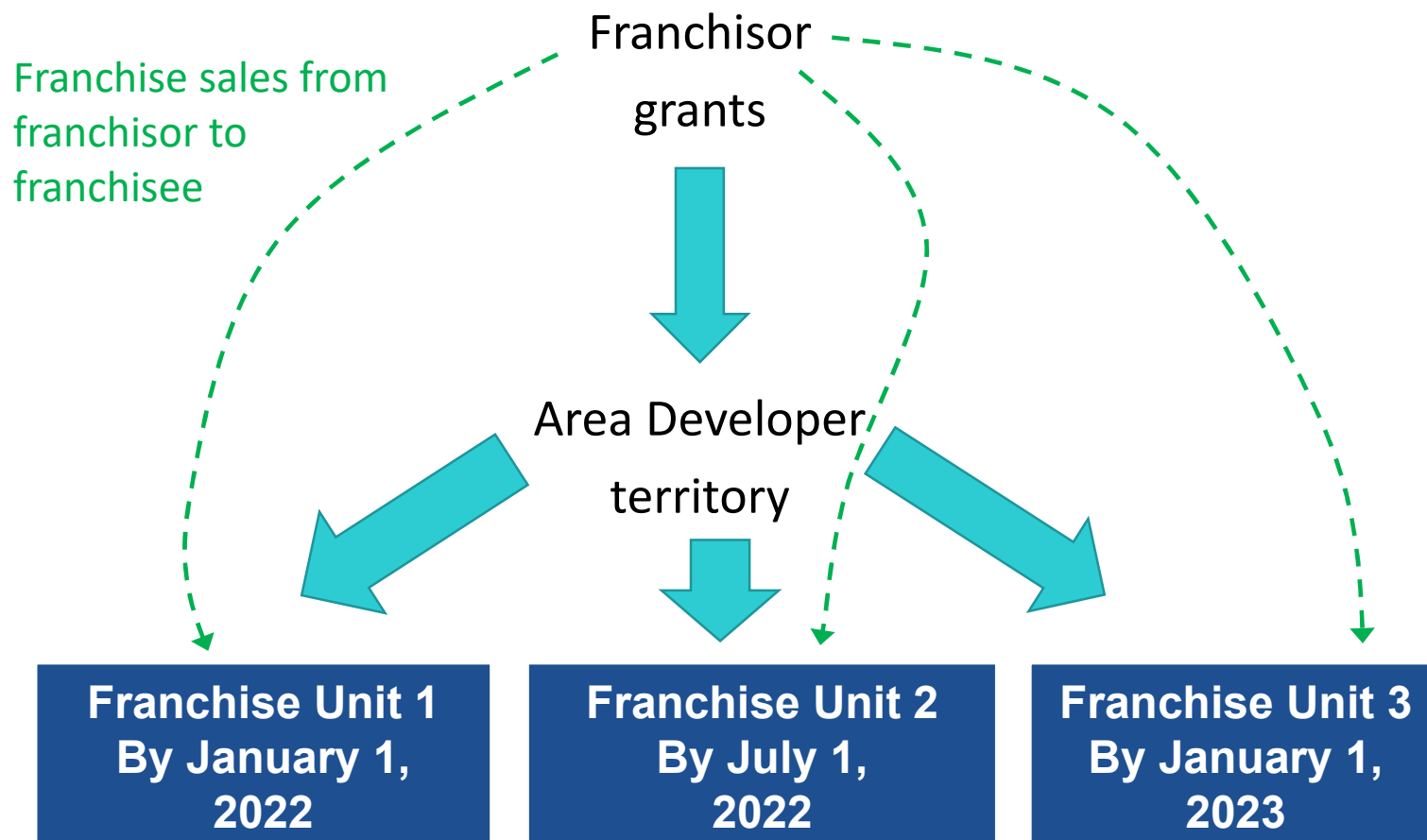


Unit Franchisee (rights to conduct business using trademark, operating system)

Key Franchise Business Models

Area Development Franchising

(multi-unit franchising)



Area Development Franchises

- 2 Agreements:
 - Area development agreement sets territory and development requirements
 - Unit franchise agreement for each outlet
 - Franchisee has contract with franchisor
 - Unit franchisee pays fees to franchisor, which pays a portion to AR / DA
- 3 Parties:
 - Franchisor (contracts with area representative / development agent) and franchisee
 - AR / DA pays AR fee to franchisor
 - Area Developer
 - Recruits franchisees on behalf of franchisor
 - Services franchisees on behalf of franchisor
 - Franchisee
 - Operates franchise
 - AR / DA has no contract with franchisee

Master Franchise Arrangements

- Master is an independent contractor
- Master uses its own resources to recruit and/or support franchisees
- Master pays franchisor a fee for this right
- Master is compensated from fees generated by franchisees assigned to him
- Master's rights are subject to meeting a development schedule
- Master indemnifies franchisor against claims of franchisees

Comparison of Key Franchise Models

<u>Unit Franchise</u>	<u>Area Development</u>	<u>Master Franchise</u>
Franchisee	Developer	Master franchisee
Opens/operates unit franchises	Opens / operates several unit franchises itself	Opens unit franchises and/or grants others right to open/operate unit franchises

Comparison of Key Franchise Models

Key Aspects of Franchise Relationship	Master Franchisee	Area Representative / Development Agent
Contract privity w/zees	Yes	No
Collect fees from zees	Yes	No
Startup support to zees	Yes	Yes
Initial training of zees	Maybe	Maybe
Ongoing support to zees	Yes	Usually
Duty to enforce franchise agreements	Yes	No
May operate unit franchise (separate agreement)	Usually	Sometimes

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BUSINESS MODELS AND AGREEMENTS:
Health Care Perspective

How Does Health Care Fit?

- Key health care terms (in all health franchise models):
 - Corporate practice of medicine doctrine
 - Anti-kickback Statute
 - Medicare and other federal or state health programs
 - State AKS / fee-splitting
 - HIPAA and state privacy/security
 - Stark Law
 - Licensure and scope of practice
 - Others?
- Where and how are these items addressed?

Additional Agreements used in Health Franchises

- Management services agreement
 - Description
 - Key terms
- Administrative services agreement
 - Description
 - Key terms
- Succession agreement for “captive” arrangements
 - Description
 - Key terms
- Business associate agreement
 - Description
 - Key terms

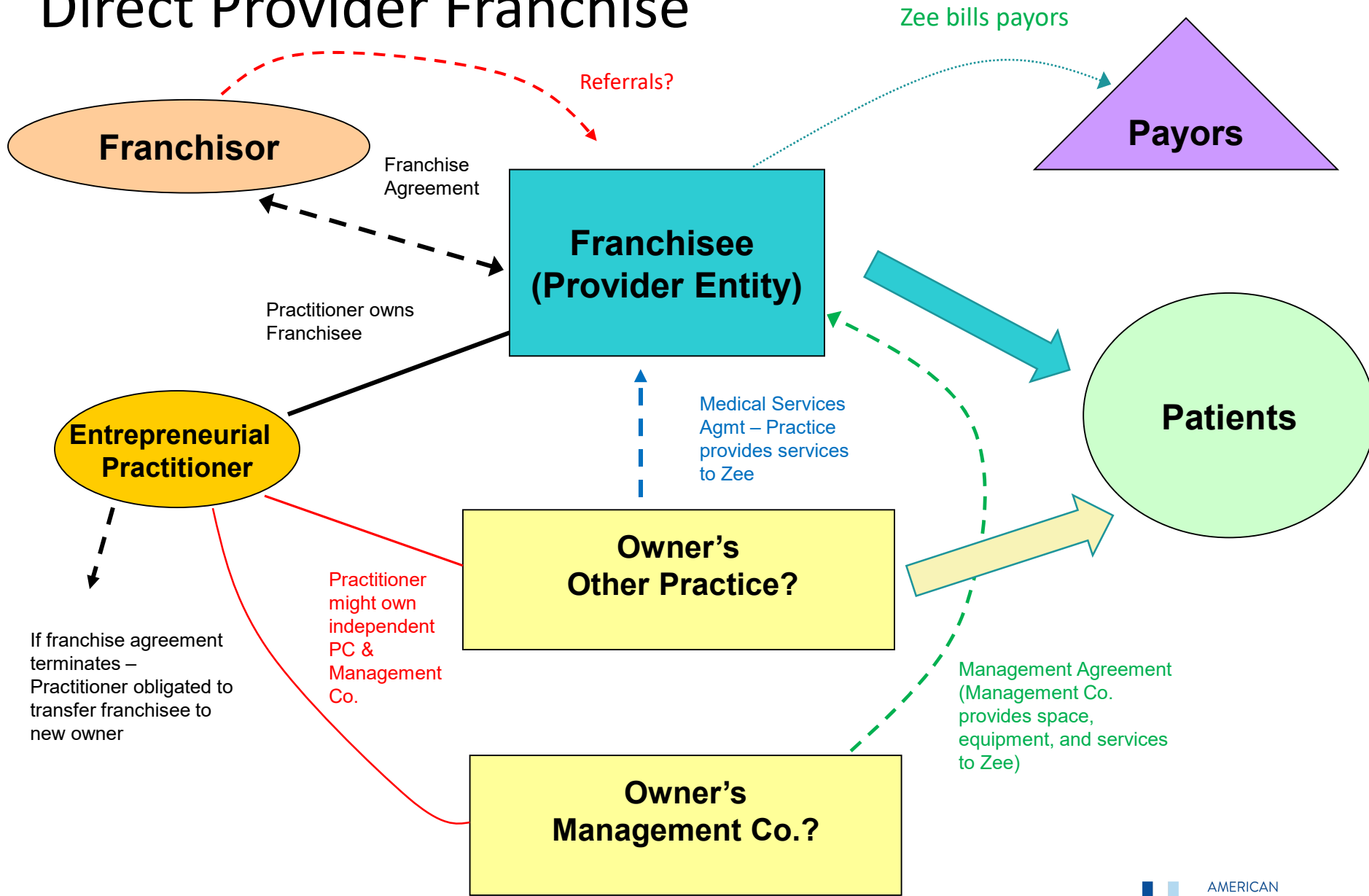
Common Business Models

- Ownership of health care provider franchise by licensed provider
 - Description of arrangement
 - Key Issues:
 - Medicare and other govt. programs
 - Commercial payors
 - AKS and Stark Law
 - HIPAA and state privacy
 - CPM and fee splitting
 - Advertising and marketing
 - Others

Common Business Models

- Ownership over quasi-health care franchise by “unlicensed” franchisee
 - Description
 - Key Issues:
 - Entity licensure?
 - “Provider” licensure & scope of practice
 - Is franchisee starting to do something that approximates “medicine”?
 - Business organization
 - State AKS and fee splitting
 - Others

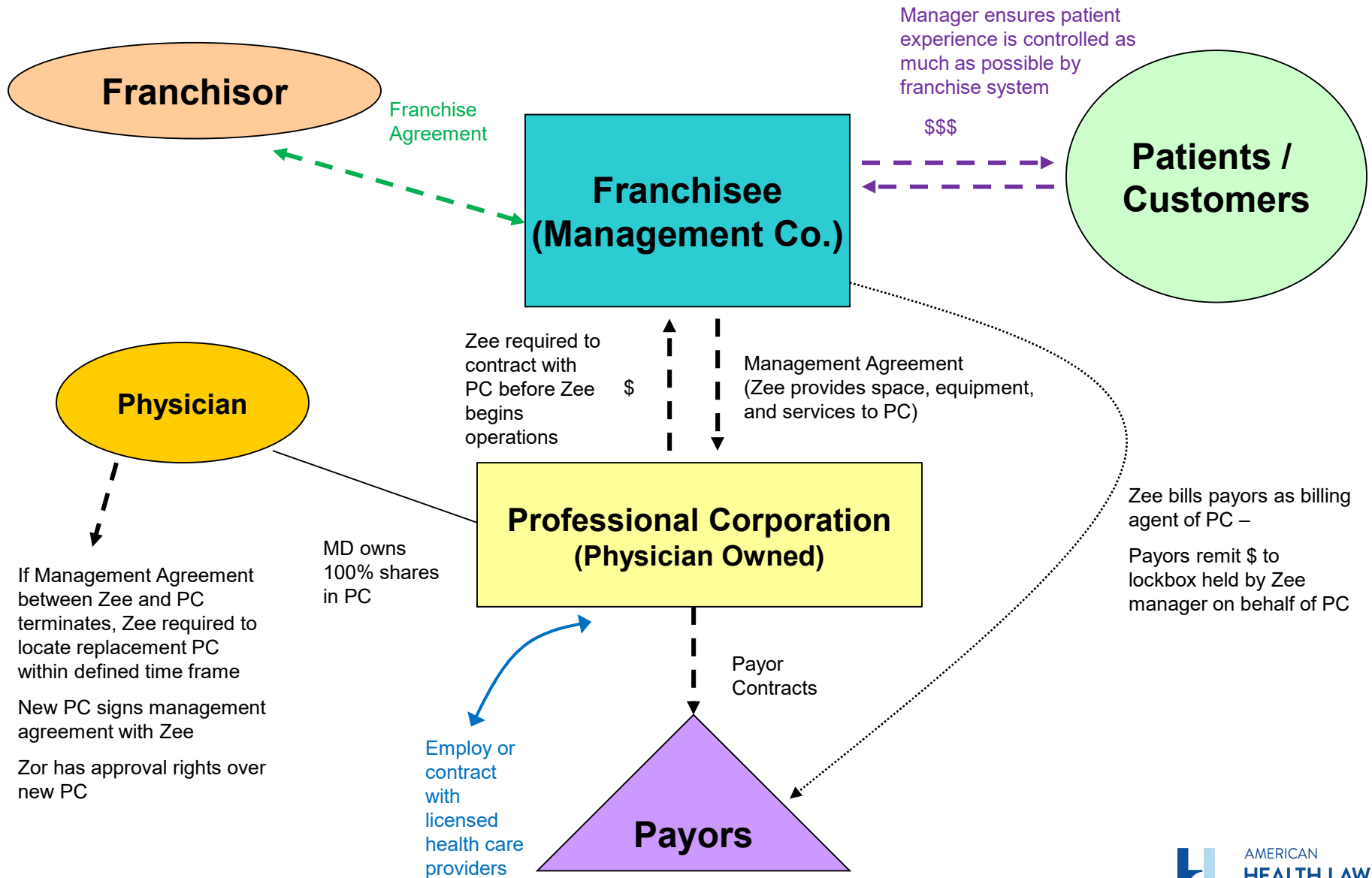
Direct Provider Franchise



Common Business Models

- Franchisee as practice manager
 - Description of arrangement
 - Key Issues:
 - CPM
 - Licensure
 - Captive medical practice
 - Federal AKS
 - HIPAA and state privacy
 - State AKS and fee splitting
 - Advertising and marketing
 - Others

Management Co. Franchise



Questions?



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