Analysis of Significant Changes
Store Franchise Agreement
Issued June 15, 2018

2018 Trade Show and Convention

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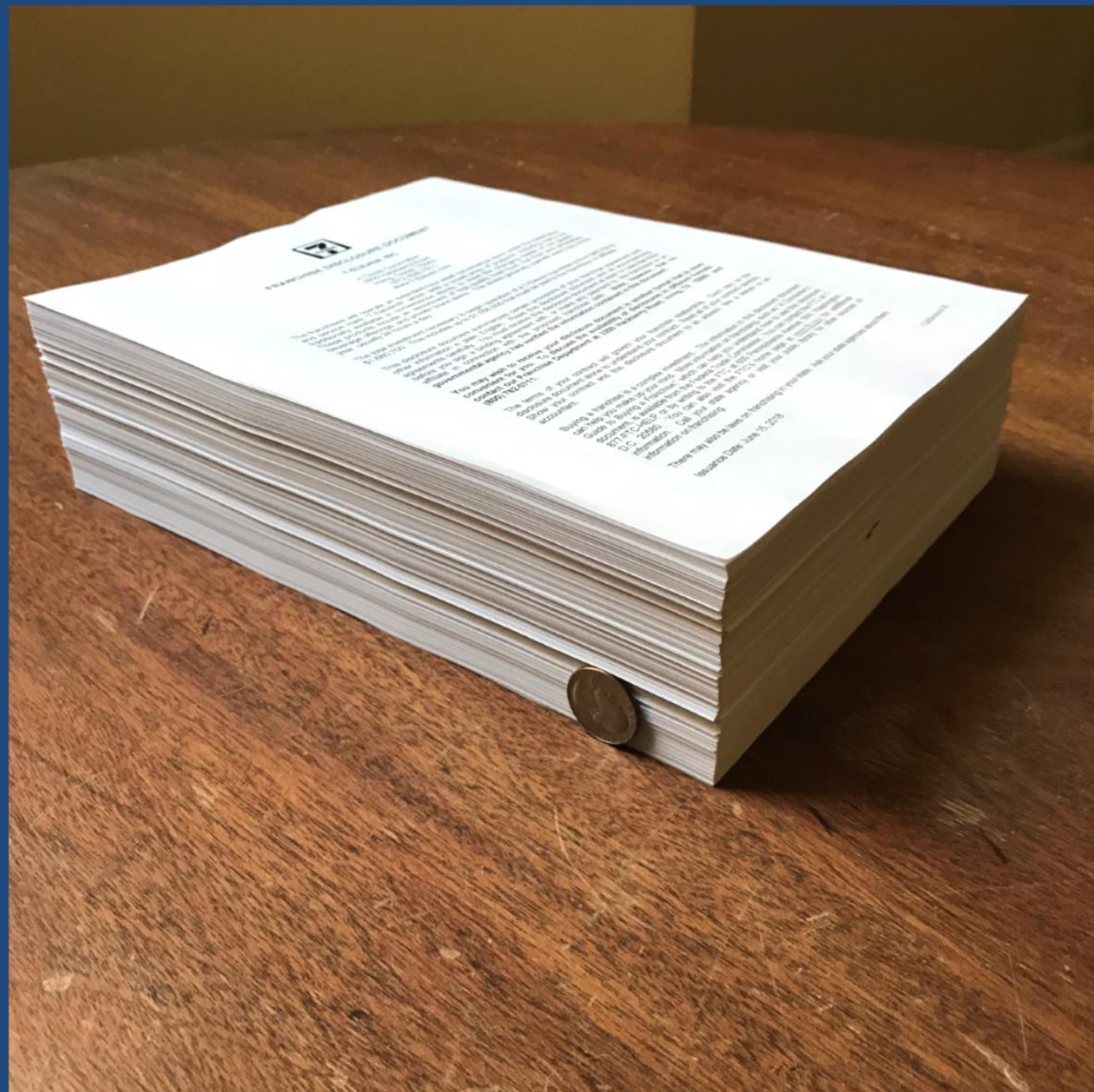
Overall Themes

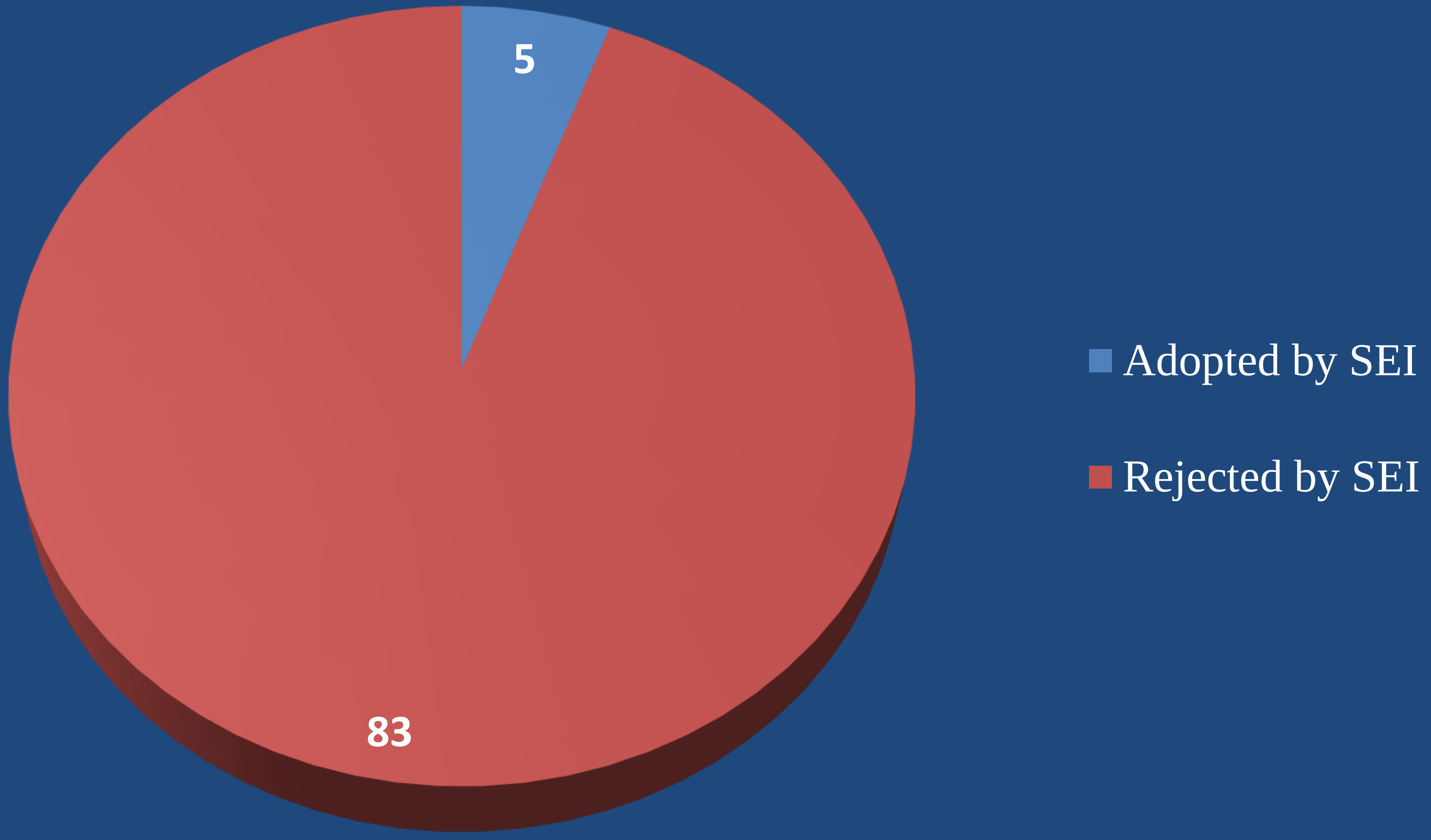
- FAC treated as window dressing
  - SEI refused to negotiate
  - Transparency rejected
  - 95% of 27 Points rejected
- Rushed process: FAQs revised twice!
- Store level economics ignored or hidden
- Swaps $ to Ad Fund for $ to SEI
- A stick and not a carrot
- Every franchisee will be affected

June 15, 2018 FDD

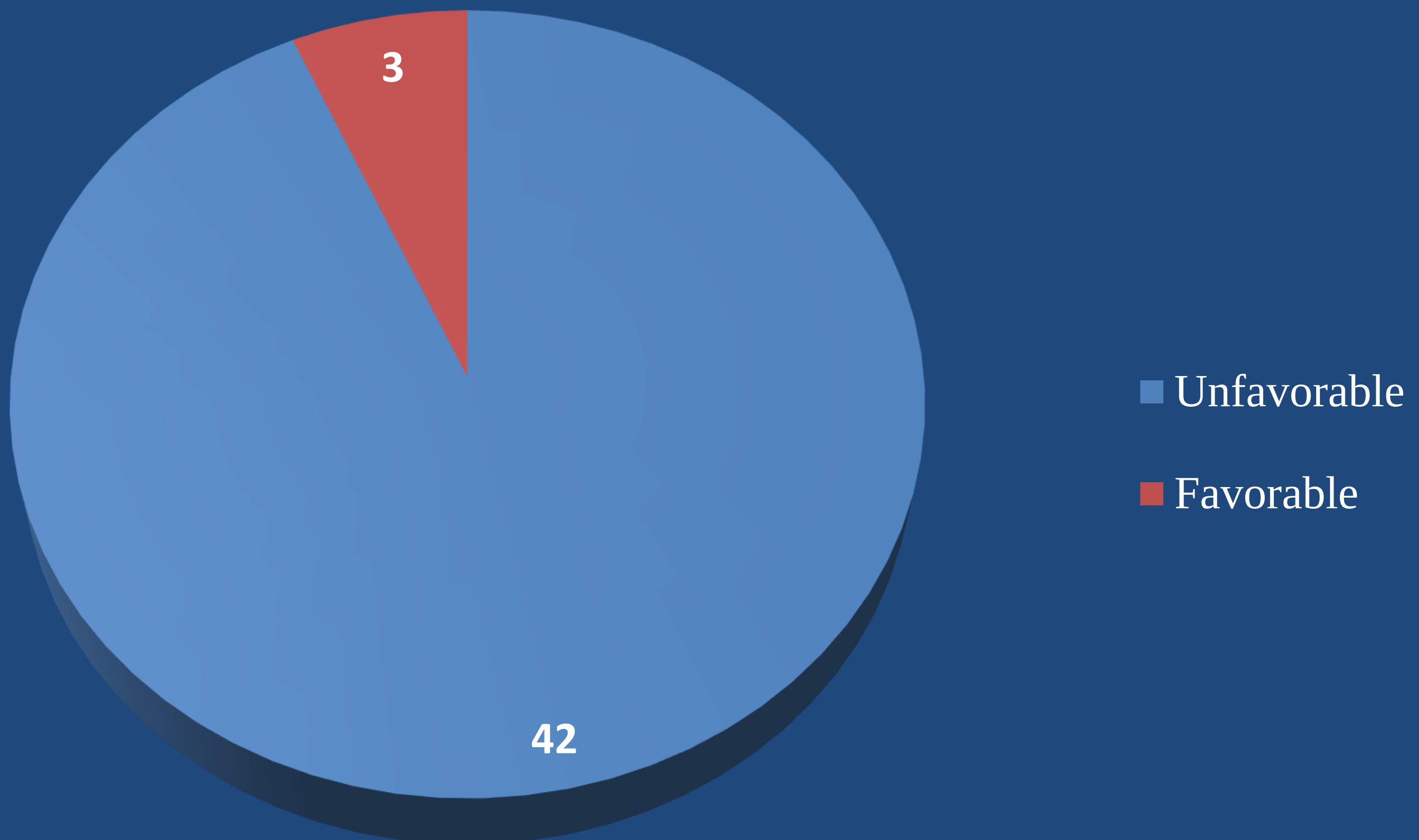
641 Pages-Nearly 7 Pounds



FAC/NCASEF/NBLC Recommendations Accepted



Favorable/Unfavorable Changes



New/Additional Costs	
Grand Opening	Delivery Service Labor & Vehicles
Manager Training	Computer Equipment
Internet Sales Fulfillment	Insurance
GGPS/GGPS-OS	Advertising Fee (low volume stores)
Employment Law Auditor	Renewal Fee
E-verify	Management Fee
Re-Audits	Legal Fees
Loyalty Program Points	Mediation Costs

Independent Contractor

Section 2

Change

- Franchisee must identify itself to the public as the owner and operator of the Store

Impact on Franchisee

- Does not change the pervasive control exercised by SEI over day-to-day Store operations

Grand Opening Fee

Sections 3, 6(c), 4(a) and 6(c) and Exhibit D

Change

- $8,000 added for franchise agreements executed on or after January 1, 2019

Impact on Franchisee

- A coercive threat hanging over the franchisee
- Makes no sense for existing stores, only newly opened stores
- Funds controlled by SEI
- SEI states that it will apply only to new stores and changeovers

Store Managers

Sections 4 and 6(b)

Change

- Franchisees with more than one store must have an approved manager
- Managers must complete training to the satisfaction of SEI
- Replaced managers must also be trained

Impact on Franchisee

- SEI claiming to distance itself from employment related issues
- Prohibits managers who do not pass the program
- Adds additional expense to the franchisee
- SEI claims it will not automatically require current managers to be trained

In Term Non-Compete

Section 5(d)(1) & Exhibit E

Change

- Competitive Business definition changed
  - Trade name with at least 50 stores
  - Offers franchises or licenses

Impact on Franchisee

- Not focused on product mix
- Focus on franchise competitors
- ½ mile radius unchanged

Post Term Non-Compete

Section 5(d)(2)

Change	**Impact on Franchisee**
• Provision deleted	• When the agreement expires, a franchisee can be in the convenience store business anywhere • One of the very few changes that favor the franchisee

Other Channels/Internet Sales

Section 7(b)

Change

- No compensation to the franchisee unless mutually agreed

Impact on Franchisee

- Related to the loyalty and delivery programs described in section 17.
- SEI is reserving to itself the revenue from all Internet and digital sales
- Power to force franchisees to incur some or all of the expenses relating to those transactions

Premises Rentals

Section 8(a)(2)

Change

- No credit to the franchisee for rentals received for use of the premises

Impact on Franchisee

- Another potential benefit to franchisees that is taken away without justification or explanation

Maintenance Expenses

Section 8(a)(3) and 20(b)

Change

- Franchisee must incur costs and make Purchases for SEI Equipment
- In-store music service subscriptions are the responsibility of the franchisee

Impact on Franchisee

- Perpetuates the built-in conflict of interest
  - SEI ownership of the equipment
  - Franchisee responsibility for maintenance

Gross Profit Split

Section 10 and Exhibit D

Change

- GGPS until SEI gives notice to convert to GGPS-OS (Graduated Gross Profit Split on Steroids).

Impact on Franchisee

- Applies to new stores
- Does not affect existing franchisees
- Reason for two stages not clear

Impact of GGPS-OS

Assumes 35% GP

Revenue	Gross Profit	50/50	50/50 v. GGPS	50/50 v. GGPS-OS	GGPS v. GGPS-OS
$1.3M	$455K	$227,500	$850	$900	$1,750
$1.7M	$595K	$297,000	$5,250	$12,100	$6,850
$2.2M	$770K	$385,000	$14,200	$27,300	$13,100
$2.6M	$910K	$455,000	$22,600	$39,800	$17,200

Gross Profit Declines

Systemwide

Period	Gross Profit Margin	+/-
December 31, 2017	34.3%	(0.5)
March 31, 2018	34.0%	(0.3)
Total 15 Months		(0.8)

Franchisee Gross Margin

2017 Franchisee CGS	Increase (0.8%)	Impact	Franchisee Share	Per Store
$8.3B	$66.3M	49.23%	$32.6M	$4,558

Draws

Section 11

Change

- Withdrawals now governed by the Operations Manual

Impact on Franchisee

- SEI reserving the right to limit the frequency of withdrawals
- Weekly or even monthly withdrawals are no longer guaranteed
- SEI benefits from the float
- Franchisees deposit $1B+/month

Wage/Hour/Immigration laws

Sections 12(c)3), 19(h) and 19(m)

Change

- Franchisee required to
  - Certify compliance
  - Participate in e-verify
  - Pay for an outside auditor chosen by SEI to confirm compliance
- Non-compliance is an event of default with a 5 day cure period.

Impact on Franchisee

- SEI claims to be distancing itself from employment related issues
- Becoming an agent of federal and state government, perhaps by agreement
- Using e-verify on current employees illegal in some states
- No estimate of the frequency and cost of the outside auditor

Franchisee Payroll

Section 12(e)

Change

- SEI not obligated to provide franchisee payroll

Impact on Franchisee

- Another expense transferred over to the franchisee
- Unless you use ADP, will not be integrated with monthly accounting/store systems
- Transparent attempt to distance SEI from employment related issues for legal but not business purposes

Vendor Payments

Section 12(e)

<u>Change</u>

- Will be "enabled" not paid by SEI.

<u>Impact on Franchisee</u>

- Significance of this change is not explained or clear
- Will franchisees be required to actually implement these payments in the future?

Operating Credit

Section 13(a)

Change	**Impact on Franchisee**
• $200/month for 60 months	• Time-limited offset for the imposition of payroll expenses on the franchisee

Minimum Net Worth

Section 13(d)

Change

- Reduced to $10,000 when SEI decides to do so
- $5,000 for subsequent stores

Impact on Franchisee

- This change was opposed by the FAC as irresponsible
- SEI gets to decide when the reduction is implemented
- FAQ says 90 days
- Less margin for error with less frequent audits

Audits

Section 14

Change

- No guarantee of quarterly audits
- Franchisee must cooperate with audits

Impact on Franchisee

- SEI *intends* to audit twice per year
- Cost savings to SEI
- Less frequent audits means unraveling discrepancies and inaccuracies will be exponentially more difficult

Re-Audits

Section 14

Change

- Within a "reasonable time", not 24 hours
- Error threshold raised from 1% to 2%.

Impact on Franchisee

- No definition of reasonable time
- Threshold for when SEI pays for the re-audit has been doubled
- SEI increasingly disavowing responsibility for audit errors

Initial Inventory

Section 15(a)

Change

- SEI not obligated to help clean and stock the Store
- SEI not obligated to provide any other services unless it deems them reasonably necessary

Impact on Franchisee

- Another benefit taken away from franchisees

Pricing

Section 15(j)

Change

- No guaranty or promise that SEI will get the best pricing and advantageous payment terms
- Not responsible if vendors violate supply chain agreements

Impact on Franchisee

- Acknowledges the truth
- Supply chain not being operated primarily for the benefit of franchisees
- Some franchisees: we can sometimes purchase inventory cheaper at big box retailers than from the SEI-controlled supply chain

Foodservice Standards

Section 16(e) and 26(b)(3)

Change

- Reflected in Operations Manual
- Franchisee entitled to just three days' notice of alleged non-compliance, not 30 days

Impact on Franchisee

- Not tied to imminent threat to public health or safety
- Subject to SEI unilateral changes
- No proportionality
- Three strikes rule applies

Loyalty Programs

Sections 17(a) and 26(b)(9)

Change

- Franchisee must participate in all customer loyalty programs
- Cost of redeeming all points earned rests with the franchisee
- Details of these programs left to SEI's future discretion
- Failure to comply is an event of default with a 15 day cure period

Impact on Franchisee

- A blank check written by SEI on the franchisee's bank account
- No limit on what loyalty point redemptions could cost the franchisee

Adequate Delivery Service

Sections 17(b) and 26(b)(9)

Change

- Franchisee is solely responsible for the cost of whatever delivery programs are mandated by SEI
- This may include the obligation to
  - Employ additional personnel
  - Acquire and insure multiple motor vehicles
- Failure to comply an event of default with a 15 day cure period

Impact on Franchisee

- Could require the franchisee to shoulder substantial additional costs in order to make these deliveries
- SEI will claim that this provision allows them to force franchisees to undertake these costs and not receive any portion of the benefit

Digital Commerce

Section 17(c)

Change

- Franchisee must participate and invest in whatever digital commerce programs are mandated by SEI
- Including the cost of computer-related equipment facilitating pickup at and delivery from the Store

Impact on Franchisee

- Suggests that SEI can issue mandates from time to time requiring
  - Investment in digital hardware
  - Additional costs to implement pickup and delivery
  - No guarantee of a corresponding benefit

Indemnification and Insurance

Section 18 and Exhibit C

Change

- Contractual indemnification has been totally eliminated.
- SEI responsible only for fire and casualty loss to the Store building and the Equipment

Impact on Franchisee

- Traditional element of the franchise system discarded
- Transfers nearly all of the insurance responsibility and associated cost to the franchisee
- Requires franchisee to name SEI as additional insured
- Typical franchisee will pay approximately $170-$230 per month for these insurance requirements
- Broad indemnification provisions may not be insurable

Meetings at Store

Section 19(c)

Change

- The franchisee must be personally present for meetings at the Store whenever requested by SEI

Impact on Franchisee

- Meetings with store managers or employees will not suffice
- This could prove very onerous to franchisees

Notice of Violations

Section 19(m)

Change

- Franchisee must notify SEI if it receives notice of any possible violation of law from any government agency

Impact on Franchisee

- Reflects SEI’s concern over its legal exposure for violations of law which occur at the franchised Store
- May relate to investigations by Homeland Security and ICE

ICE Targets 7-Eleven Stores In Nationwide Immigration Raids

January 10, 2018

Federal immigration enforcement agents raided 7-Eleven stores across the country early Wednesday, in search of employees who are in the U.S. illegally and managers who knowingly employ them.

Agents with U.S. Immigration and Customs Enforcement conducted sweeps of 98 stores in 17 states and Washington, D.C., arresting 21 people on suspicion of being in the country illegally.

It's the largest operation against a single employer since President Trump assumed office.

Hours of Operation

Definitions – Page E-9

24 Hour Operation means your operation of the Store 24 hours a day, 7 days a week, ~~(except at your option, Christmas day)~~, 365 days a year.

Maintenance Contracts

Section 20(b)

Change

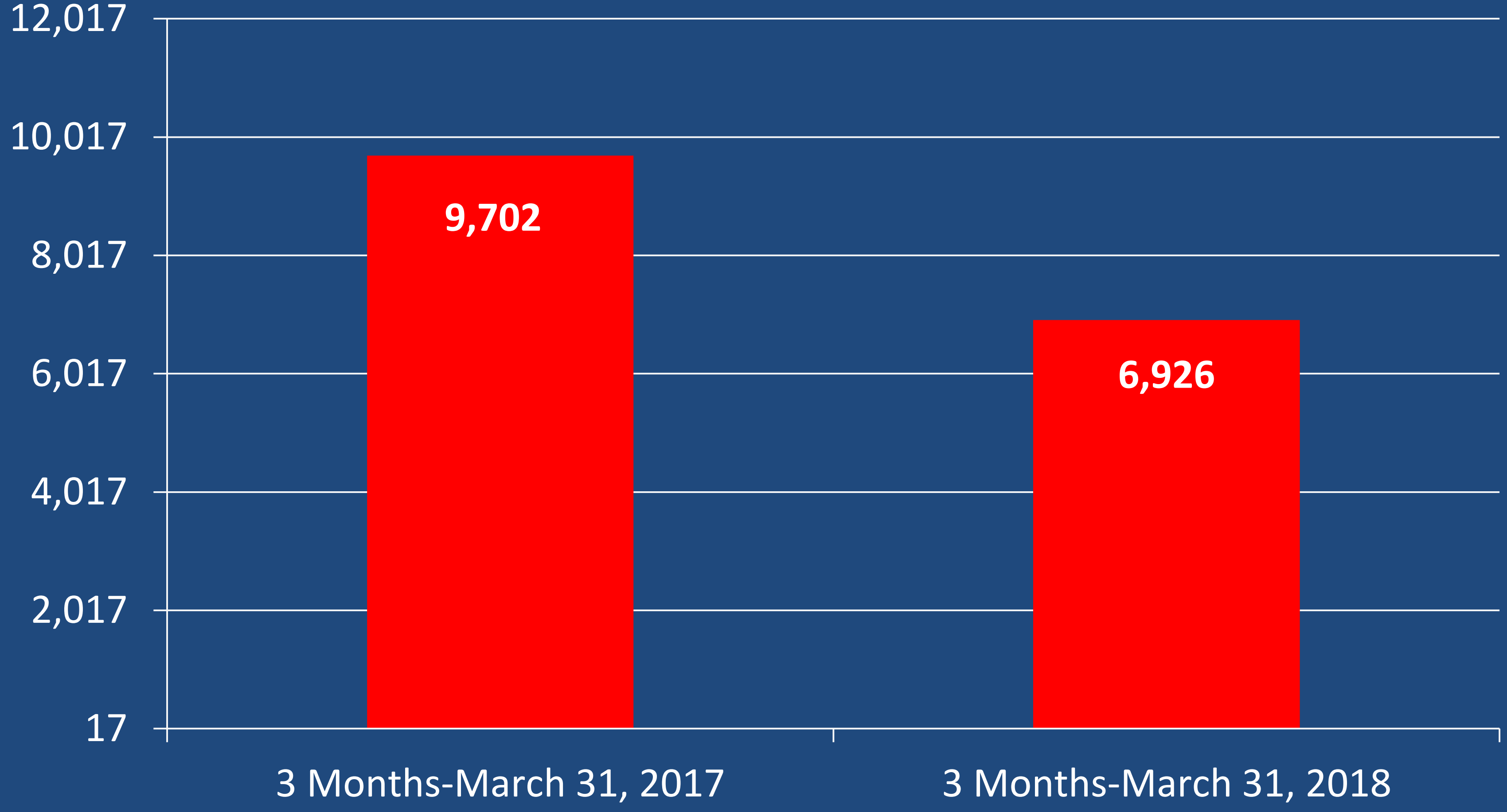
- SEI reserves the right to use itself or its affiliates as the equipment maintenance contractor
- SEI may
  - Stop arranging for performance of the maintenance services
  - Require the franchisee to use contractors it approves for required maintenance

Impact on Franchisee

- Codifies the built-in conflict of interest that SEI has created
  - Forcing franchisees to maintain equipment beyond its useful life
  - Refusing to commit to capital investments to replace worn out equipment on a schedule that meets industry standards

Existing Store Cap-Ex Declines

(Millions of Yen)



Advertising Fee

Section 22(a)

Change

- Flat 1% of GP starting January 2019.

Impact on Franchisee

- This change provides relief to franchisees with gross profit above $342,855
- An increase for those below that number
- Dollars otherwise used for advertising go to SEI bottom line through higher GP split

Use of Marks

Section 23(c)

Change

- Cannot use SEI trademark on
  - employment-related materials
  - domain name
  - email address
  - other online use or presence

Impact on Franchisee

- Driven by SEI's attempt to distance itself from employment related issues
- Based on Ochoa v. McDonalds

Renewal Fee

Section 24(j)

Change

- The renewal fee is a flat $50,000
- Not 20% of the franchise fee that would be charged for that store

Impact on Franchisee

- This is the highest franchise renewal fee known to exist in all franchise systems in the U.S
- No portion allocated to renovation or refurbishment

Renewal Term

Section 24

Change

- A single renewal term of unspecified duration

Impact on Franchisee

- There is no floor on how short the term of the renewal franchise agreement might be
- After that renewal, no further renewals are promised

Form of Renewal Agreement

Section 24(h)

Change

- The form of renewal agreement may be materially different from
  - the expiring agreement
  - the agreement being offered to franchisees for new stores

Impact on Franchisee

- In this section, which is unprecedented in franchising.
- SEI is reserving the right to create *custom renewal agreements* for renewing franchisees
- May not be the same as that being offered to new franchisees entering the system or even other franchisees renewing at the same time

Transfer by Franchisee

Section 25(b)

Change

- Any transfer of any interest in a franchisee entity requires SEI consent

Impact on Franchisee

- If the franchisee is a corporation or limited liability company, the transfer of as little as 1% of the ownership could trigger all of the transfer requirements under the franchise agreement

Right of First Refusal

Section 25(c)

Change

- SEI has 15 days (not 10 days) to exercise
- Closing can be in up to 60 days (not 10 days)

Impact on Franchisee

- 15 day right refusal is not materially worse for the franchisee than 10 days
- Extension of 60 days to close if SEI does not exercise its right of first refusal, actually benefits the franchisee

Termination

Section 26

Change

- Completely rewritten in a fashion that is very difficult to discern the changes, perhaps purposely so
- Previously only one event of default for which there was no notice and no cure period. Now there are 12 such events
- Cure period for many events of default shortened substantially
  - For example, the cure period of Foodservice standards has been changed from 30 days to 3 days

Impact on Franchisee

- New cross default provision
- Some defaults under one agreement are a default under all other franchise agreements held by the franchisee or its affiliates
- SEI's characterization of these wholesale changes as a "streamlining" is intentionally misleading

Non-Curable Default-Immediate Termination

Section 26(a)

2017 Agreement

1. Violate Terrorism laws

2018 Agreement

1. Violate Terrorism laws
2. Application misrepresentation
3. False sales reports
4. Violate laws
5. Abandon store
6. Unapproved transfer
7. Felony conviction
8. Unethical/immoral behavior
9. Disclose Confidential data
10. Bankruptcy
11. Four strikes/24 months
12. Agreement declared invalid

Store Transfer

Section 26(e)

2017 Agreement

- New location must be "comparable"

2018 Agreement

- There is no definition of a "comparable" location

SEI Management of Store

Section 26(f)

Change

- Any criminal proceeding (not just a felony) or incident may trigger
- SEI will charge a management fee of up to 5% of GP plus its out-of-pocket expenses

Impact on Franchisee

- Any criminal proceeding, however minor the offense, or any incident at the Store, even if it does not lead to criminal proceeding, could lead to an SEI takeover of the Store
- There is no limit on or definition of "out-of-pocket expenses"

Mediation

Section 29

Change

- Not required
- Either party can opt out or terminate at any time
- SEI pays 50% (not 2/3 of the costs)
- Does not apply to 12 non-curable defaults

Impact on Franchisee

- Mediation can often resolve disputes through the intervention of a neutral person
- SEI has recently made a mockery of the mediation alternative by refusing to participate or to negotiate
- This change reflects SEI actual practices

Governing Law

Section 30(a)

Change

- Texas law governs

Impact on Franchisee

- An attempt to deprive franchisees of the benefit of franchise relationship laws in 18 home states that may benefit them
- Texas has no statutory protections for franchisees

Venue for Disputes

Section 30(b)

Change

- Lawsuits must be filed in court closest to SEI home office
- SEI may seek injunctive relief in franchisee locale

Impact on Franchisee

- Long distance litigation is more expensive
- Seeking home town advantage and favoritism

Costs and Attorney Fees

Section 30(c)

Change

- SEI recovers legal fees
  - Even if no legal proceeding filed
  - Even if it does not prevail

Impact on Franchisee

- A characteristically one-sided provision
- Even if the franchisee wins the case, SEI can recover their legal fees and the franchisee cannot

Jury Trial

Section 30(d)

Change

- Waived by both parties

Impact on Franchisee

- This is a mutual waiver of the constitutional right to a jury trial

Limitation of Claims

Section 30(e)

Change

- Must be filed within two (2) years of when the claim arises
- Whether or not the franchisee knows that there is a claim

Impact on Franchisee

- Designed to cut off claims if not filed within two years
- Even if the franchisee has no idea that a claim exists

Notices

Section 31(h)

Change

- May be sent by email only

Impact on Franchisee

- Franchisees will be required to constantly monitor email communications from SEI

Business Judgment

Section 31(n)

Change

- SEI may make decisions based on what is good for it or the system, no matter its impact on the franchisee

Impact on Franchisee

- A transparent attempt to void the implied covenant of good faith and fair dealing
- Exists in all 50 states
- Obligates both parties not to do anything to deprive the other party of the intended fruits of the bargain
- Purports to allows SEI to make decisions based on its own self-interest without considering the impact on the franchisee

2004 Agreement

- **Option One**
  - Sign at renewal
  - GGPS and other terms per then current agreement
- **Option Two**
  - Sign by 12/31/18
  - Existing GPS to 12/31/29
  - GGPS thereafter per then current agreement
- **Option Three**
  - Sign by 12/31/18
  - Five year term
  - 50/50 GPS until sell store or expiration
  - If no sale, walk away-no franchise fee rebate

2006 to 2009 Agreements

- **Option One**
  - Sign at expiration date
  - GGPS/other terms as defined in then current agreement
- **Option Two**
  - Sign by 12/31/18
  - Existing GGPS to 12/31/29
  - GGPS thereafter per then current agreement

2010 to Present Agreements

- **Option One**
  - Sign at expiration date
  - GGPS as defined in then current agreement
  - Prorate renewal fee; 36 months; no interest
- **Option Two**
  - Sign by 12/31/18
  - Existing GGPS to 12/31/29
  - GGPS thereafter per then current agreement
  - Prorate renewal fee; 36 months; no interest

Questions