

**ADMINISTRATIVE PROCEEDING
BEFORE THE
SECURITIES COMMISSIONER OF MARYLAND**

In the Matter of:

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REDRHINO, INC.,

*

a.k.a. REDRHINO: The Epoxy Flooring Company

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MICHAEL KENEALY, and

Case Number 2015-0382

*

CHRISTOPHER CONNER,

*

Respondents.

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ORDER TO SHOW CAUSE

WHEREAS, the Securities Division of the Office of the Attorney General of Maryland (the “Securities Division”) initiated an investigation into the franchise-related activities of REDRHINO, Inc., a.k.a. REDRHINO: The Epoxy Flooring Company, Michael Kenealy, and Christopher Connor (collectively “Respondents”) under the authority granted under the Maryland Franchise Registration and Disclosure Law, MD. BUS. REG. CODE ANN. §§14-201 et seq. (2015 Repl. Vol.) (the “Maryland Franchise Law”); and

WHEREAS, as a result of that investigation, the Maryland Securities Commissioner (the “Commissioner”) has found grounds to allege that Respondents violated the anti-fraud, registration, and disclosure provisions of the Maryland Franchise Law, in relation to the offer to sell, and sale of REDRHINO franchises in Maryland;

NOW, THEREFORE, the Commissioner hereby orders Respondents to show cause why a final order should not be entered ordering each of them to permanently cease and desist from violating the anti-fraud, registration, and disclosure provisions of the Maryland Franchise Law.

The Commissioner alleges the following as a basis for this Order:

I. JURISDICTION

1. The Commissioner has jurisdiction in this proceeding and over Respondents pursuant to section 14-210 (a) of the Maryland Franchise Law.

II. STATEMENT OF FACTS

A. Respondents

2. REDRHINO, Inc., a.k.a. REDRHINO: The Epoxy Flooring Company, Inc. (“Red Rhino”), is or was a California corporation with a principal business address of 929 E. Second Street, Unit 106, Los Angeles, California 90012. Red Rhino maintains an Internet website at www.redrhinoflooring.com.

3. Red Rhino offers and sells franchises in the form of Management Agreements for individuals or businesses (hereafter “franchisees”) to sell and install epoxy flooring for commercial and residential applications using the names “REDRHINO” and “REDRHINO: The Epoxy Flooring Company.”

4. On Red Rhino’s website, in a link captioned “franchise-opportunities,” Red Rhino states that it provides services through regional partners, referred to as “franchisees.” Red Rhino invites interested persons to contact it for information about opening a REDRHINO franchise.

5. Michael Kenealy (“Kenealy”) is the founder, president, and owner of Red Rhino.

6. Christopher J. Connor (“Connor”) is the president of Franchise Marketing Systems, a franchise consulting firm or franchise broker that, for a commission, offers and sells franchises. Connor also identified himself as “Franchise Director” of Red Rhino.

7. Connor solicited individuals, including at least one Maryland resident, to enter into Red Rhino Management Agreements.

B. The Red Rhino Franchise Offering

8. In the Fall of 2013, AW, a resident of Laurel, Maryland saw an advertisement online for franchise opportunities for less than \$25,000. AW responded to the advertisement and requested information.

9. Shortly after sending his request for information, AW received an e-mail from Connor, identifying himself as Franchise Director of Red Rhino.

10. On October 11, 2013, Connor sent AW information about the Red Rhino franchise offering, including a brochure in the form of a letter signed by Kenealy captioned “Become a Red Rhino Franchise Owner in 2012.”

11. In the brochure, Kenealy states that in 2009, four years after starting Red Rhino, his business grossed just over \$750,000. He states that Red Rhino’s “continued and ongoing success has led to its further expansion through the benefits and force of franchising.”

12. On October 11, 2013, Connor also sent AW a document entitled “Franchise Assumptions.”

13. Kenealy was copied on the e-mail that Connor sent AW that included the Franchise Assumptions.

14. The Franchise Assumptions worksheet assumed franchisee gross sales from \$265,000 in the first year, to \$876,000 in the fifth year. The worksheet included assumptions of a \$15,000 franchise fee, a 7% royalty on gross sales, local advertising of 1%, and corporate advertising of 5%.

15. The Franchise Assumptions included a representation of the amount of initial investment a prospective Red Rhino franchisee could expect to make, from a “low” of \$25,300 to a “high” of \$43,800.

16. The Franchise Assumptions document also included a pro forma representing

amounts of revenue, variable expenses, operating expenses, and total expenses that a prospective Red Rhino franchisee could expect to achieve. The document included a representation that franchisees could expect a return on their investment of between 137% in the first year, to 983% in the fifth year.

17. Before he signed his Red Rhino Management Agreement, AW spoke to both Connor and Kenealy about the Red Rhino franchise opportunity.

18. On November 23, 2013, AW signed a Red Rhino Management Agreement (“2013 Management Agreement”). Under that 2013 Management Agreement, AW agreed to pay Red Rhino an initial fee of \$25,000 for the right to operate a Red Rhino business in an exclusive territory that included parts of Maryland, Washington, DC and its surrounding areas, including part of Northern Virginia, West Virginia, and Pittsburgh, PA for an initial term of five years.

19. Under the 2013 Management Agreement, AW also agreed to pay Red Rhino a royalty of 7% on all gross collections produced through the Red Rhino sales and business development model.

20. Under the 2013 Management Agreement, Red Rhino agreed to provide sales and marketing support, a minimum of two weeks of training at Red Rhino headquarters in Los Angeles, California, onsite support and resources, systems, processes and methods for operating a Red Rhino business, and ongoing support and guidance, including marketing and sales support. Red Rhino also agreed to provide, manage, and oversee lead generation efforts to produce web based customer leads.

21. Although not specified in the 2013 Management Agreement, Red Rhino required AW to pay additional fees for marketing.

22. In December 2013, AW received 4 days of training at Red Rhino headquarters rather than the two weeks specified in the 2013 Management Agreement.

23. AW also received from Red Rhino information on downloading Red Rhino's logo for use in the operation of his business, including on uniforms and marketing materials.

24. On March 7, 2014, AW signed a new Management Agreement ("2014 Management Agreement") with Red Rhino, in which AW agreed to pay an additional \$10,000 initial fee in exchange for an expanded exclusive territory that included most of the State of Pennsylvania.

25. In February 2015, Red Rhino offered AW a third Management Agreement that would expand his territory to include the entire State of Virginia. That third Management Agreement stated that the franchisee would "agree to transition to a Franchise Disclosure document when REDRHINO is granted approval to Virginia franchise registration [sic]."

26. AW did not sign the third Management Agreement but maintained his existing territories under the 2014 Management Agreement.

27. Red Rhino began directing to a Red Rhino franchisee located in Virginia leads located within AW's exclusive territory in Northern Virginia that should have been referred to AW.

28. Red Rhino has never registered to offer and sell franchises under the Maryland Franchise Law.

29. Red Rhino never gave a Franchise Disclosure Document ("FDD") to AW before AW signed the 2013 or 2014 Management Agreements.

30. Although AW exceeded the assumed gross sales listed on the pro forma that Connor sent to him as part of the Franchise Assumptions, AW never achieved anything close to the return on his investment represented in that document.

COUNT ONE
(Violation of Registration Provisions)

WHEREAS, section 14-228 of the Maryland Franchise Law makes it unlawful for any person

to offer to sell, through advertisement or otherwise, or sell a franchise in Maryland or to a Maryland resident unless the offering has been registered with the Commissioner before the person offers to sell, through advertisement or otherwise, or sells the franchise in Maryland; and

WHEREAS, Respondents advertised, offered to sell franchises, and/or sold a franchise in Maryland without registering the offering with the Commissioner;

NOW, THEREFORE, IT IS HEREBY ORDERED that Respondents show cause why they should not be ordered to permanently cease and desist from the offer or sale of franchises in Maryland in violation of the registration provisions of section 14-228 of the Maryland Franchise Law.

COUNT TWO
(Violation of Disclosure Provisions)

WHEREAS, section 14-223 of the Maryland Franchise Law makes it unlawful for any person to offer to sell or sell a franchise in Maryland or to a Maryland resident without first giving a prospective franchisee a copy of the offering prospectus and a copy of each proposed agreement that relates to the sale of the franchise at the earlier of: (1) 14 calendar days before the execution by the prospective franchisee of any binding agreement with the franchisor; (2) 14 calendar days before payment of any consideration that relates to the franchise relationship; or (3) a reasonable request by a prospective franchisee to receive a copy of the offering prospectus; and

WHEREAS, under section 14-216 (a) and COMAR 02.02.08.04, the “offering prospectus” that a franchisor must give to a prospective franchisee is the Franchise Disclosure Document that is registered by the Securities Division and that contains 23 separate Items of disclosure; and

WHEREAS, Respondents offered to sell or sold a franchise in Maryland without giving a prospective Maryland franchisee the offering prospectus required under the Maryland Franchise Law

at any time before the Maryland franchisee paid consideration or signed a binding contract related to the franchise;

NOW, THEREFORE, IT IS HEREBY ORDERED that Respondents show cause why they should not be ordered to permanently cease and desist from the offer and sale of franchises in violation of the disclosure provisions of section 14-223 of the Maryland Franchise Law.

COUNT THREE

(Misrepresentation in connection with the offer or sale of franchises)

WHEREAS, section 14-229 of the Maryland Franchise Law prohibits any person, in connection with the offer to sell or sale of a franchise, directly or indirectly, to employ a device, scheme or artifice to defraud; make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or engage in any act, practice, or course of business which operates or would operate as a fraud or deceit on any person; and

WHEREAS, in connection with the offer and sale of a franchise, Respondents made material misrepresentations of fact about the Red Rhino franchise offering, including misrepresenting the training to be provided to franchisees, the fees required to be paid under the Red Rhino Management Agreement, and the nature of the exclusive territories sold under the Red Rhino Management Agreement; and

WHEREAS, in connection with the offer and sale of a franchise, Respondents made material omissions of fact about the Red Rhino franchise offering, including failing to disclose all fees franchisees were required to pay under the Management Agreement, and failing to disclose that the Red Rhino Management Agreements constitute franchises;

NOW, THEREFORE, IT IS HEREBY ORDERED that Respondents show cause why they should not be ordered to permanently cease and desist from the offer and sale of franchises in violation of the anti-fraud provisions of section 14-229 of the Maryland Franchise Law.

COUNT FOUR
(Earnings Claims)

WHEREAS, section 14-229 of the Maryland Franchise Law and COMAR 02.02.08.16(D) prohibit any person, in connection with the offer to sell or sale of a franchise, directly or indirectly, to make any oral or written statements concerning the potential earnings from operation of a franchise (“Earnings Claim”) if that Earnings Claim has not been included in the franchisor’s FDD; and

WHEREAS, Respondents made Earnings Claims about the Red Rhino franchise offering in the form of projection of earnings and pro forma contained in the Franchise Assumptions provided to AW, but Respondents did not make the required disclosures about that Earnings Claim, or any Earnings Claim, in an FDD or in any writing given to that prospective franchisee;

NOW THEREFORE, IT IS HEREBY ORDERED, that Respondents show cause why a final order should not be issued against them directing them to permanently cease and desist from the offer and sale of franchises in violation of the Maryland Franchise Law.

**REQUIREMENT OF ANSWER AND
NOTICE OF OPPORTUNITY FOR HEARING**

IT IS FURTHER ORDERED, pursuant to section 14-210 of the Maryland Franchise Law and COMAR 02.02.06.06, that Respondents shall file with the Commissioner a written Answer to this Order within fifteen days of service of the Order. The Answer shall admit or deny each

factual allegation in the Order and shall set forth affirmative defenses, if any. A respondent without knowledge or information sufficient to form a belief as to the truth of an allegation shall so state.

The Answer also shall indicate whether a respondent requests a hearing. A hearing will be scheduled in this matter if one is requested in writing. Failure by any respondent to file a written request for a hearing in this matter shall be deemed a waiver by that respondent of the right to such a hearing. Failure of any respondent to file an Answer, including a request for a hearing, shall result in entry of a final order directing that Respondent to permanently cease and desist from violation of the Maryland Franchise Law.

SO ORDERED:

Commissioner's Signature on
File w/Original Document

Dated: November 4, 2015

MELANIE SENTER LUBIN
SECURITIES COMMISSIONER