

1 **STATE OF WASHINGTON**  
2 **DEPARTMENT OF FINANCIAL INSTITUTIONS**  
3 **SECURITIES DIVISION**

4 IN THE MATTER OF DETERMINING  
5 Whether there has been a violation of the  
6 Franchise Investment Protection Act of  
7 Washington by:

8 NEIGHBORHOOD NETWORKS  
9 PUBLISHING, INC.,

Respondent

Order No.: S-18-2456-18-SC01

STATEMENT OF CHARGES AND  
NOTICE OF INTENT TO  
ENTER ORDER TO CEASE AND DESIST

10 THE STATE OF WASHINGTON TO:

Neighborhood Networks Publishing, Inc.

11 **STATEMENT OF CHARGES**

12 Please take notice that the Securities Administrator for the state of Washington has reason to believe  
13 that Respondent, Neighborhood Networks Publishing, Inc., has violated the Franchise Investment Protection  
14 Act of Washington, RCW 19.100, and that its violations justify the entry of an order of the Securities  
15 Administrator under RCW 19.100.248 to cease and desist from such violations. The Securities Administrator  
16 finds as follows:

17 **TENTATIVE FINDINGS OF FACT**

18 **I.**

19 **Respondent**

20 1. Neighborhood Networks Publishing, Inc. ("N2 Inc.") is a Delaware corporation that was  
21 formed on January 16, 2009.<sup>1</sup> Its principal place of business is in Wilmington, North Carolina. N2 Inc.  
22 publishes magazines and/or newsletters for residential communities. Each N2 Inc. publication is specific to a  
23 particular residential community. N2 Inc. also sells advertising space within these publications to local

<sup>1</sup> N2 Inc. was formerly incorporated in Missouri and North Carolina.

1 businesses. N2 Inc. contracts with local area directors who sell the advertisements and help generate content  
2 for the publications.

### 3 **Related Entity**

4 2. N2 Franchising, LLC d/b/a N2 Publishing (“N2 Franchising”) is a Delaware limited liability  
5 company that was formed on October 26, 2016. It has the same principal place of business as N2 Inc. in  
6 Wilmington, North Carolina. It is in the business of offering and selling franchises for businesses that are  
7 similar to N2 Inc.’s area directorships. N2 Franchising is currently licensed with the Securities Division to  
8 sell such franchises, and has been since January 3, 2017. It has a pending application with the Securities  
9 Division to register a similar, but separate, franchise that involves publications that focus on the real estate  
10 industry. Most of the Washington area directors that are the subject of this Statement of Charges have  
11 converted their area director arrangements to franchises.

## 12 **II.**

### 13 **Nature of the Conduct**

14 3. Beginning no later than February 2010 to at least July 2017, N2 Inc. offered and sold area  
15 director arrangements to at least 30 Washington residents. Area directors sold advertising in N2 Inc.’s  
16 publications to local businesses and community members, and offered N2 Inc. services, including N2 Inc.’s  
17 advertising design services, to the community. They also provided content to N2 Inc. for publication. N2 Inc.  
18 designed, published, printed, and distributed the publication to those within the specific community or  
19 industry. N2 Inc. provided area directors with a marketing plan and business system that area directors were  
20 to comply with, granted area directors the right to use N2 Inc.’s trademarks in their business, and charged the  
21 area director a royalty to continue the business.

### 22 **N2 Inc. Granted Area Directors the Right To Use Its Trademarks**

23 4. N2 Inc. entered into a written agreement with each area director (the “Agreement”), effective

1 for one to three years. In the Agreement, N2 Inc. granted area directors a limited license to use its trademarks,  
2 service marks and copyrighted materials to advertise and promote their N2 Inc. publication business. For  
3 example, area directors were often provided with their own “n2pub.com” email, a domain that N2 Inc. owns,  
4 to use in marketing their N2 Inc. business. N2 Inc.’s logo also appeared on the inside cover of the publications.

### 5 **N2 Inc. Provided Area Directors With A Marketing Plan**

6 5. N2 Inc. established a marketing plan that provided guidance to area directors and a system  
7 within which area directors were to operate. N2 Inc. provided its area directors with a multi-day training and  
8 held periodic conference calls with area directors to provide sales tips and consultation. Area directors were  
9 only allowed to sell products and services approved by N2 Inc., under the terms and pricing set by N2 Inc.  
10 N2 Inc. required its area directors to use its form contracts when selling advertisements to local businesses,  
11 and area directors had to send the contracts to N2 Inc. for approval and execution. N2 Inc. also required area  
12 directors to obtain its prior approval if the area director wanted to use their own marketing materials. More  
13 generally, N2 Inc. required its area directors follow its standards and procedures in operating their businesses.  
14 N2 Inc. had the right to terminate any area director arrangement if an area director failed to follow N2 Inc.’s  
15 standards and procedures, or failed to follow any other provision of the Agreement after an opportunity to  
16 cure.

### 17 **N2 Inc. Required Area Directors To Pay An Indirect Franchise Fee**

18 6. N2 Inc. charged and collected an indirect franchise fee from area directors in the form of a  
19 15% royalty fee called the “N2 Cost.”<sup>2</sup> In the Agreement, N2 Inc. defined the N2 Cost as 15% of the  
20 “Advertising Value of each N2 Publication, whether or not N2 actually receives payment for the

21 \_\_\_\_\_  
22 <sup>2</sup> In the most recent franchise disclosure document that N2 Inc.’s affiliate, N2 Franchising, filed with the Securities Division as  
23 part of its pending application to franchise a business substantially similar to the area directorships (see Paragraph 2), N2 Franchising  
lists an “N2 Royalty” that it charges to franchisees via a deduction from the franchisee’s commission. N2 Franchising described the  
N2 Royalty as “15% of the advertising value of each publication.” The N2 Royalty was previously called “N2 Cost” in an earlier  
version of the franchise disclosure document.

1 advertisements.” The Agreement defined “Advertising Value” as “the value of the advertising in each N2  
2 Publication, as determined by N2 Inc. in its discretion.”

3 7. N2 Inc. deducted the 15% N2 Cost from the area director’s monthly commission payment. N2  
4 Inc. compensated the area directors in this manner because ad purchasers were required to pay for their  
5 advertisements by remitting payment directly to N2 Inc. N2 Inc. then deducted the N2 Cost, the actual  
6 publication cost, and other miscellaneous costs and fees from the revenue that it received before paying the  
7 remainder to the area director as a monthly commission.

8 8. If an area director’s advertisement sales did not generate enough actual revenue to N2 Inc. in  
9 any month to cover the area director’s deductions, including the N2 Cost, then the area director did not receive  
10 a commission payment for that month. N2 Inc. then deducted the uncovered portion of the N2 Cost and other  
11 deductions from the area director’s commission payment for the following month. If an area director did not  
12 bring in enough actual revenue to cover the N2 Cost and other deductions for more than two consecutive  
13 months, then N2 Inc. had the right to terminate the Agreement.

### 14 III.

#### 15 **Misrepresentations and Omissions**

16 9. N2 Inc. did not provide any of the Washington area directors with a franchise disclosure  
17 document (“FDD”) prior to the sale of the area director arrangements. The FDD provides a potential  
18 franchisee with information such as the cost of the franchise, the business and litigation background of the  
19 company’s principals, and the number of opened and closed franchises over the past three years. The FDD  
20 must be prepared in accordance with separate guidelines promulgated by the Federal Trade Commission and  
21 the North American Securities Administrators Association, Inc. A franchisor who chooses to make financial  
22 performance representations in its FDD must provide certain information, in accordance with the guidelines,  
23 so that the representations are not misleading.

1           10.     Instead of making financial performance representations within an FDD and in accordance  
2 with regulatory guidelines, N2 Inc. made these representations in advertisements and online videos that it  
3 used to sell area director arrangements. N2 Inc. made the financial performance representations in a manner  
4 that was misleading because it failed to provide material information regarding the representations. For  
5 example, in a 2015 advertisement, N2 Inc. represented that “[t]he average Area Director earns between \$70k-  
6 \$100k and top performers earn in excess of \$200k+ annually.” N2 Inc. made a similar statement in an  
7 advertisement the following year. Neither advertisement contained any other information that would provide  
8 context for these figures, such as the sample size that was used to determine the average, the geographic  
9 location of the area directors that formed the basis for these figures, or the length of time the area directors  
10 had been with N2 Inc.

11           11.     Similarly, in a 15 minute video that N2 Inc. posted on its website ([www.n2pub.com](http://www.n2pub.com)), designed  
12 to help area directors decide “whether or not N2 is a good fit,” N2 Inc. provided earnings examples for three  
13 area directors that were misleading. N2 Inc. showed the area directors’ cash received, expenses, and take-  
14 home earnings for the startup phase (typically the first 12-15 months of operations) or for the second year of  
15 operations. N2 Inc.’s example showed those in the startup phase earned no income during the first few months  
16 of ramping up, but thereafter earned income that increased overall by the end of the period. One of these area  
17 directors earned over \$10,000 in one month towards the end of the startup phase. In the example for an area  
18 director’s second year of operations, N2 Inc. showed that the area director earned over \$185,000 total after  
19 expenses were deducted. In none of these examples did N2 Inc. include any information that would provide  
20 more context for these earnings figures, including the area directors’ geographic location, how many  
21 publications each area director owned, how many hours the area directors worked to achieve these results, or  
22 how typical the results were.

23 //

1 **IV.**  
2 **Registration Status**

3 12. Respondent N2 Inc. is not currently registered to sell its franchises in the state of Washington  
4 and has not previously been so registered. There is no notification of exemption on file with the state of  
5 Washington.

6 Based upon the above Tentative Findings of Fact, the following Conclusions of Law are made:

7 **CONCLUSIONS OF LAW**

8 **I.**

9 The offer and sale of the N2 Inc. area director arrangements as described above constitutes the offer  
10 or sale of a franchise as defined in RCW 19.100.010(6), RCW 19.100.010(12), and RCW 19.100.010(17).

11 **II.**

12 The offer or sale of said franchise was in violation of RCW 19.100.020 because no registration for  
13 such offer or sale is on file with the Washington Securities Administrator for the time period when offers  
14 and/or sales occurred.

15 **III.**

16 The offers and/or sale of said franchises were in violation of RCW 19.100.080, the disclosure  
17 document requirement provision of the Franchise Investment Protection Act, because Respondent N2 Inc.  
18 failed to provide prospective purchasers with a current disclosure document that contained all material  
19 information about the franchise including, but not necessarily limited to, information related to earnings  
20 claims or financial performance representations that would make such claims or representations not  
21 misleading.

22 //

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23

**IV.**

The offers and/or sale of said franchises were made in violation of RCW 19.100.170 because, in offering and/or selling franchises to Washington residents, N2 Inc. omitted material facts regarding its financial performance representations that were necessary for the representations to not be misleading.

**NOTICE OF INTENT TO ORDER THE RESPONDENT TO CEASE AND DESIST**

Based upon the above Tentative Findings of Fact and Conclusions of Law, the Securities Administrator intends to order that Respondent Neighborhood Networks Publishing, Inc., and its agents and employees, each shall cease and desist from violations of RCW 19.100.020, RCW 19.100.080 and RCW 19.100.170.

**AUTHORITY AND PROCEDURE**

This Order is entered pursuant to the provisions of RCW 19.100.248 and is subject to the provisions of Chapter 34.05 RCW. Respondent Neighborhood Networks Publishing, Inc. may make a written request for a hearing as set forth in the NOTICE OF OPPORTUNITY TO DEFEND AND OPPORTUNITY FOR HEARING accompanying this order. If Respondent does not request a hearing within the allowed time, the Securities Administrator intends to adopt the above Tentative Findings of Fact and Conclusions of Law as final and enter an order to cease and desist permanent as to Respondent.

Signed and Entered this 5th day of November, 2018.



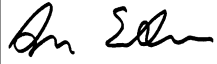
---

WILLIAM M. BEATTY  
Securities Administrator

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23

//  
//

Approved by:



---

SUZANNE SARASON  
Chief of Enforcement

Presented by:



---

HUONG LAM  
Financial Legal Examiner

Reviewed by:



---

JACK MCCLELLAN  
Financial Legal Examiner Supervisor