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Your Franchise:

Getting In,
Getting Out,
And Everything
In Between


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While franchises appear to be just like any other businesses, the truth is they are not. Franchises add an additional layer of challenges and considerations that present themselves throughout the life cycle of the business. A franchisee who does not understand the implications of franchising stands to be unpleasantly surprised at some point during the lifetime of the business.

Getting In

Joining a franchise is like becoming a member of an exclusive club. Membership does not include a secret handshake, or special knock. However, it does include, among other things, a proprietary method of doing business, support, and a license to use a trademark. In exchange for these accoutrements, franchisees must agree to follow certain rules, which are laid out in franchise agreements. These documents – most of which are so thick they can stop a bullet – are the heart and soul of the franchise relationship. Since that relationship will typically last 10 years or more, franchisees need to understand their franchise agreements before signing, and should secure modifications to those agreements wherever possible.

There are literally hundreds of questions that can be asked before entering into a franchise, including the following:

1. LIABILITIES –

- Who is liable if the franchisor sues the franchisee? Is the franchisee personally liable?
- Are the franchisee's personal assets vulnerable to judgments and seizure?
- Can personal liability be limited in scope or effect?

2. COVENANTS NOT TO COMPETE –

- If the franchised business terminates, will the franchisee be permitted to operate another business in the same location?
- Are managers, employees and family members also prohibited from operating after termination?

Is the restriction enforceable under applicable law?

3. EXCLUSIVETERRITORY –

- Is there an area of protection or exclusivity?
- Is the protective language worded in such a way as to be ambiguous and open to interpretation?
- Is the franchise agreement sufficiently worded to protect the franchisee from other franchisees? From company-owned stores? From similar brands?
- Does the franchisor reserve the right to place other franchisees in hand picked locations inside the franchisee's territory?
- Are there triggering events that can result in the loss or modification of the territory? What happens if the population in the franchisee's territory changes, is the territory subject to change?
- Will the territory be preserved in renewal franchise agreements or can the franchisor modify or take it away at the time of renewal?

4. TERMINATION –

- Are the termination provisions fair?
- Is the franchisor required to give the franchisee adequate notice of default and an opportunity to cure that default before termination?
- Are there unusual grounds for termination by the franchisor?
- Are there liquidated damages provisions?
- Are there minimum royalty thresholds that make proving damages for breach easier at trial?

All of the above questions are important, and depending on the franchisee, can be game changers. And while many franchisees will not be able to negotiate for changes to each and every threatening provision in their franchise agreement, they must at least be comfortable with the rules before committing to them. Ignorance is not bliss when it comes to franchising.





Getting Out

In addition to understanding the rules, franchisees must also consider their end-game. In this regard, franchising presents some important realities that franchisees must understand. Franchised businesses, by their nature, are not transferable without franchisor involvement and approval. Franchisors always retain control over who can join the ranks of their systems. As such, franchisees typically do not have the unfettered discretion to sell their business to third-parties and must involve their franchisors when effectuating even the smallest equity transfers. This means that most franchisees do not have the unfettered right to give part or all of the business to their kids. And they cannot offer to bring new owners and partners into the franchise at will. Franchisees must understand these dynamics before joining a franchise.

Franchisees must also understand what happens if they die while owning the franchise. Franchise agreements vary widely in their treatment of this issue, so franchisees should pay close attention to their agreements.

All franchise agreements are not created equal when it comes to transfers. It is therefore vital that franchisees obtain competent professional advice early in the process, so that they understand any limitations prior to committing to a particular franchise.

Everyone understands it's foolish to marry a complete stranger. Similarly, franchisees should not sign a franchise agreement without understanding it. Failure to understand the relationship can only lead to trouble down the road.

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Brian is a commercial litigator with more than fifteen years of experience representing clients in the franchise industry. Brian routinely assists clients during the licensing and franchise/FDD review process, as well as with the resolution of franchise-related disputes, including those involving terminations, territorial disputes, fraud, disclosure/relationship law violations and breaches of contract.