the Business Law Group

7 THINGS YOU NEED TO KNOW BEFORE SIGNING A FRANCHISE AGREEMENT

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THANKS FOR REQUESTING THIS SPECIAL REPORT!

I don't want to waste your time, so let's first establish who this report is for. This report will be useful to you if:

- **YOU** are thinking about buying a franchise and want to prepare yourself for the process;
- **YOU** are talking to a franchisor and have been provided with a franchise disclosure document; or
- **YOU** are about to sign a franchise agreement.

This report will ***not*** be useful to you if:

- **YOU** are an adviser and are looking to boost your expertise on franchise law;
- **YOU** have already signed a franchise agreement and want out; or
- **YOU** are a franchisor and are trying to get a look into the minds of potential franchisees

The goal of this report is to offer seven of the most important but overlooked aspects of signing a franchise agreement. You can read through the pages upon pages of the franchise agreement, and if you're able to stay awake, most of it might even make some sense. At the very least you'll understand most of the provision in the franchise agreement because it was written in plain language, not some legalese mess. That alone though is not enough.

Let's look at a couple of questions. If you can answer "yes" to the following list, then you're probably all set. If not, I would encourage you to read on. In the franchise agreement, do you:

A. Understand all its provisions?
B. Know what provisions are missing?
C. Know how the various provisions interact with one another?
D. Know what your options are if you don't like certain provisions?
E. Know if all the provisions can legally be included by the franchisor?

If you answered "no" to one or more of these, there's nothing to be ashamed of; there was a time when I would have answered "no" to all five of those questions. Heck, I'm sure that most attorneys can't answer "yes" to all five. There's a reason why most business lawyers do not provide their services to franchises: it takes experience in working with franchises to really know your stuff.

Buying a franchise is a great way to get into a business because many franchises really have all their processes down from A to Z. As an owner, it really is plug-and-play. The franchisor has likely vetted your credentials to make sure you are a suitable owner and many will help you train and select a location. Your job really entails following the system the franchisor has established, working hard, and doing what you do best.

Before you get to the end of the track and start making plans to expand your business empire, there are some big hurdles that you have to clear, the most prominent of which is coming to an agreement with the franchisor.

A franchise agreement has to be provided to you when the franchisor presents the franchise disclosure document—it gives you a first look into the franchisor's standard franchise agreement. After your allotted review time of the franchise disclosure document,[1] and after the franchisor has vetted you, a franchise agreement for your specific situation is drafted.

These documents are usually fairly complicated. In fact, there are few contracts that can compare in both length and complexity. There's a lot of ground that needs to be covered under the agreement, and often time it spills over into attached agreements or sub-agreements that are incorporated into the franchise agreement.

So what do YOU need to know about these daunting contracts? Are there common tricks that franchisors try to pull on unsuspecting franchisees? Do YOU really need an attorney to review the franchise agreement for you? Here are seven things that you need to know before signing a franchise agreement:

[1] I would highly recommend that, even if you're in love with the franchise, you heavily vet them by contacting current and previous franchisees. Buying a franchise is a big commitment, and there's a reason why federal and Michigan law requires that you have time to vet that franchise. If you choose not to take action and the relationship ends up not being what you expected, then you're the one left in a bad situation.

1. YOU Really Can Negotiate the Terms

Let's say the franchisor sent you a copy of the franchise agreement to review with the franchise disclosure document. The next version of the franchise agreement that was sent to you to sign looks nearly identical but it has your information filled in. This is a standard agreement, right? You have no ground to ask for terms to be changed so you might as well sign it and move on, right? Wrong.

Yes, there are many situations where we as consumers are stuck with the terms of the standard agreement put in front of us. If you want that new cell phone, you must abide by your phone carrier's special terms and conditions: you're left with the option of signing or not getting that new phone. A franchise agreement, however, is not a situation where you are a consumer. In fact, you have leverage.

Let me add the caveat that most franchisors are likely not going to receive wholesale changes to the franchise agreement well. If you are hoping to rewrite the entire document from the bottom up, including changing everything from the length of the agreement to what inspection rights the franchisor has to what payments have to be made to what jurisdiction's laws will apply if a dispute arises, do not expect the franchisor to cooperate.

A franchisor makes money by recruiting franchisees that are able to successfully sell products and services to the end users. The more successful franchisees a franchisor can onboard, the more revenue it can produce. This means that, unlike a cell phone carrier looking to sell a phone and plan to a consumer, a franchisor is much more motivated to get you to become a franchisee. The franchisor’s desire increases according to how much time and energy he or she invests in vetting your credentials, preparing a territory and location for you, getting training set up, and more as the process continues.

This all puts YOU in a position of power. However, the playing field is still not level as explained above because the franchisor can break off negotiations at any point and walk away. While the franchisor does not want to walk away from what it has invested in the process, a franchisor will still walk away when the deal becomes more of a headache than its worth.

With the leverage you have, though, you can change some of the terms of the agreement. The less affect those changes have on the general spirit of the franchise agreement, the more likely they are to be accepted by the franchisor. I’ve been surprised at some of the changes to the franchise agreement that franchisors are willing to concede to.

2. How Long Are YOU Really Committed?

Many franchise agreements require you to commit to running the franchise for five years or more. That can seem like a long-term commitment but, in reality, you may also be committed beyond that time period.

A franchise allows you to immediately jump into owning a successful business that might be totally unrelated to your previous background. You could have worked the past twenty years as a janitor and, after buying into a pizza franchise, you’re suddenly selling hundreds of pizzas a day.

For you to benefit from the franchisor’s system, the franchisor has to open up to you about all of its trade secrets, sourcing information, and knowledge of how to run a successful business. This is a lot of proprietary information that a franchise will go to great lengths to protect.

This is exactly why franchise agreements will contain lengthy restrictions, such as non-disclosure agreements, non-competition clauses, and non-solicitation agreements. These restrictive clauses will almost always survive the termination of the franchise agreement and will run for months if not years after your time as a franchisee has ended.

Let’s look at our janitor turned pizzeria owner. What affect do those restrictive covenants have on her if she doesn’t see any real benefit in being a franchisee or if she thinks there’s a better way to run a pizzeria? She may decide that she won’t renew her franchise agreement and will instead strike out on her own, which very likely means that she can’t stay in the same location. The franchisee may have to find new vendors, staff, suppliers, and other business relationships. She will have to develop all new recipes and products. Our former pizza franchisee is basically left to either wait a couple years for the restrictive covenants to expire or try to open a brand new business where she will have to develop brand new business relationships in a brand new location, possibly hundreds of miles from the previous location.

So, even though the franchise agreement includes a commitment to running the franchise for five years, is it really five years? You have to look closely at those terms that will affect you after the franchise agreement is terminated.

3. **What Is YOUR Escape Plan?**

The franchisor invests a lot in you after you sign the franchise agreement. They are training you, supporting you, and protecting you. At the same time, they are not accepting any other potential franchisees in your territory. If you were to up and quit, it would cost the franchisor money.

The franchise agreement will be drafted so to make it difficult for you to get out of the franchise agreement. Harsh default provisions, liquidated damages, and other preventative measures are put in place to let you know what the cost of quitting would be.

There's always the option to sell the franchise to someone else, of course. This can be a tantalizing option because not only do you get away from a situation you are not happy in, but also you might make a few bucks on the way out. Not so fast.

The franchise agreement likely has limitations that prevent the transferring of the franchise to someone else. At a minimum, the franchisor will want the right to approve or deny who you sell your franchise to. These restrictions can extend to requiring a transfer fee be paid to the franchisor (which will affect any payment you may receive) or requiring you to sign a personal guarantee. Some franchise agreements will even prevent you from selling your location to another franchisee in the system without approval.

Even though no one buys into a franchise believing he or she will not see it through to the end of the term, this is not an uncommon situation that arises. Before signing anything, you should know the hoops that you have to jump through if you do want to get out early.

4. **Do YOU Really Have Control over YOUR Business?**

Many franchise opportunities are pitched as "be your own boss" or "own your own business." While there's nothing false or fraudulent with these statements, they should be taken with a grain of salt.

Franchise agreements are rife with requirements on how to run the business, including: What type of marketing you can do, what products or services you provide, how you make the products or provide the services, the uniforms employees wear, where you get supplies or raw materials from, how your store is laid out, how your accounting should be done, and what positions you fill for your staff.

There's not a standard list that every franchise requires you complete. Some allow you to conduct your own marketing efforts (in fact some require that you spend a certain amount on your own personal marketing efforts). Others require all the franchisees in an area to pool their marketing budgets to run group marketing that the franchisor oversees.

It's important that you know what type of control you have over your business. You may have some unique ideas on how to boost business that you're excited to implement, but you might not be allowed to do them under the franchise agreement. However, remember what we talked about above: you might be able to negotiate these terms to allow you to act more independently in some areas.

5. Do Those Sub-Agreements Affect YOU?

It's likely that, when you sign the franchise agreement, you'll be asked to sign the franchise agreement itself and then more documents after that. Those agreements that you sign after are just as important as the franchise agreement, but they often get overlooked.

Promissory notes, guarantees, waivers, and acknowledgements can all have long-lasting effects on you. If you waive a right by signing an agreement that you think is just a formality, the franchisor may have failed to comply with a law or committed some type of fraud and by signing that agreement it is now difficult or impossible for you to enforce your rights.

It's not only important that you review all those sub-agreements thoroughly, but also that you understand the provisions of those documents, their impact on the franchise agreement, and their impact on you. Those agreements are binding and, if you breach a term found in a sub-agreement, you might be held in breach of the entire franchise agreement.

6. Is the Franchisor Complying with the Law in YOUR state?

There are federal franchise laws with which a franchisor must comply. In addition to those requirements, twelve states have their own franchise regulations. These regulations vary from state-to-state and in how intensive they are. Michigan is a regulated state; thus there are certain requirements that a franchisor must meet.

Now you might be sitting there and questioning why this is important. I agree with you that it seems like, if the franchisor is in violation of federal law or a state-specific law, that seems like a franchisor problem and not your problem.

In fact it should be a huge problem for you and should send a bright red flag up when it comes to your consideration of signing the franchise agreement. If the franchisor is not in compliance with the laws that regulates franchises, that should be a warning that the franchisor is not well represented by advisors that know franchise law. If that is the case, do you think the franchise agreement or the disclosure documents are complete?

What if the franchisor is so far out of compliance that it cannot remain solvent if an attorney general brings charges or those violations? Everything the franchisor has promised to provide you under the franchise agreement might be worthless or non-existent if the franchisor goes out of business.

While you might not need to be worried about making the correct disclosures, meeting statutory requirements, and complying with other laws, it's important to know that you're working with a legitimate franchisor, which means you need to know if the franchisor is doing everything required throughout the process.

7. Are YOUR Demands Really in the Agreement?

It's one thing for a franchisor to acquiesce to something in negotiations or to make some type of claim, representation, or guarantee during a conversation—it's a whole different story as to whether these statements make their way into the franchise agreement.

Often times, the individual drafting the agreement is not the same person that you are in contact with, which can lead to information being lost in translation or certain provisions not being spelled out properly.

There is also a dirty secret that the franchisor won't tell you: they don't review and update their standard terms that often, and thus certain provisions might be absent or incorrect.

I once represented a client who asked me to be part of a conversation with the franchisor's agent. The agent went on and on about a certain guarantee that the franchisor had for all of its franchisees. It was a great selling point and the agent was sure to drive it home, yet the problem arose when the guarantee was absent from the franchise agreement. When confronted with the absence of the guarantee in the contract language, the agent was in shock. He tried to comb through the language to find it during the meeting, then had to the leave the meeting to look into it. When he contacted me less than two days later, he said that even though they had been making the guarantee for over a year, the updated language had not made it into the franchise agreement. NO ONE HAD CALLED THEM OUT ON IT UNTIL NOW!

This is not a sign that the franchisor is trying to pull a fast one on you or that is incompetent. It's not uncommon for these mistakes to be made when a document is being updated and negotiated. In the above situation, management and sales likely decided that they could make the guarantee but it was never properly communicated to their attorney to update the documents appropriately. The bigger problem is how many franchisees heard the guarantee but agreed to terms that didn't contain the guarantee.

Knowing that you are agreeing to what you think you are agreeing to is very important. In fact, every franchise agreement contains a provision that states that if a term is not in the written agreement, it's not enforceable. That means that even if it's agreed to in negotiations, the franchisor can admit that it was agreed to in negotiations and you still might not be able to enforce it because it's not written.

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Franchise agreements are complicated documents with numerous ins and outs. It's rare that anyone that is not a franchisor will be party to more than one or two of these documents. Because of this rarity, it makes little sense to try to become an expert on franchise agreements. In fact the hundreds of hours that you will spend scouring the internet for articles and information will cost you more than hiring an expert to take you through the process.

The cost of getting into a franchise generally starts in the tens of thousands of dollars and quickly goes up from there, which is a large investment especially when you are also locked in for five, ten, or more years on top of that monetary commitment. Why would you risk anything?

You wouldn't try and inspect a house you are looking at buying based on some internet articles you read. And you sure as heck do not trust the seller of that house when they say that the house
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is in "tip-top shape." Is the investment in a franchise really that much different than a new home purchase?

Thank you again for taking the time to read this report. We hope that you now have some points to look at when negotiating and reviewing your franchise agreements. We are a very proud small business and we are dedicated to supporting others like us. That means providing you with the tools and information to make good, solid business decisions. Good luck to you.

We wish you great success!

Andrew Longcore

P.S.: If you found this report useful but still would like some more help, please feel free to send me an email at alongcore@businesslawgr.com or call our firm at (616) 528-0007. I would love to hear what you have going on and where you see your future going.

P.P.S. If you have any specific questions regarding your franchise agreement, send them to alongcore@businesslawgr.com. Be sure to put "Re: Franchise Agreement Report" in the subject line and I will personally respond to you within 48 hours. And that is 48 hours and not 48 business hours because businesses don't get weekends off!