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The Franchise Agreement

Well, you've done the important background research on the Franchise that you have selected, both into the Franchisor and the System. You've spoken to several other Franchisees, met a couple and you may even have arranged your funding. All that's needed is to sign on the dotted line of something called a Franchise Agreement and you are off and running. Who needs legal advice when you could simply put pen to paper and start making serious money.

This approach is one that is adopted by many Franchisees and regrettably many of them only go to see a Solicitor if a problem arises and at that time they often only become aware of what is in the Franchise Contract for the first time. So what can a Solicitor do for a Franchisee and just what is this Franchise Agreement and why is it so important?

The Franchise Agreement regulates the relationship between the Franchisor and the Franchisee regarding the operation of the System that the Franchisor has developed and which the Franchisor requires be carefully followed to ensure that the business is operated successfully and that there is a degree of uniformity across the business - after all that is what makes the Franchise business successful.

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The Solicitor will explain what is contained in this Agreement and what the pitfalls are for the Franchisee if he fails to observe the terms of the Agreement. How the Franchise System operates is detailed in the Manual which is the day to day working document for the Franchise - the Operations guide. This is often the critical document and if the Franchisor is willing to allow you to have a read through a copy then it is highly important that you take advantage of this and find out what the day to day running of the business entails. The Franchisor's glossy brochures and indicative figures will not be detailed nor capable or being relied upon once the Agreement has been signed. The Agreement overrides anything that the Franchisor has told you or given in writing before it is signed. The Agreement is more general than the Manual detailing what each party must do to make the relationship successful, i.e. their obligations to each other.

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You are spending a lot of money in buying the Franchise and therefore you need to know and to understand the rules that apply to the operation of the business which are detailed within the Agreement. Some Franchises require a Deposit which is usually refundable and is in the region of £2,000. This is often paid to reserve the Territory for the Franchisee whilst a Property is located (if one is necessary) for the operation of the Franchise Business). It is refunded after an agreed period which is usually around six months if a property hasn't been located and signed up, unless the parties agree to extend this period.

“...I came upon a very distressed Franchisee recently who had served the required notice at the end of the first 5 year period...”

The Franchisee can also be asked to sign a Confidentiality Agreement to ensure that the Franchisor is protected against confidential information being divulged to a third party. Often such an Agreement contains a requirement for the information to be kept confidential long after the Franchisee has decided not to proceed and some Franchisors require a restrictive covenant to be agreed which prevents the Franchisee from working in a franchise business of a similar nature for a period of time (usually up to a year). Although you will be well aware of what the Franchisor's Initial Fee is for acquiring the Territory the Agreement will tell you whether or not the Franchisor requires a Renewal Fee to be paid after the end of each term. The term normally lasts between 5 and 10 years. I came upon a very distressed Franchisee recently who had served the required notice at the end of the first 5 year period only to discover that the contract stipulated that he required to pay a further £7,500 to renew the Agreement for a further 5 year term. He hadn't taken legal advice when he signed up initially and he had not bothered to read the Agreement in detail himself.

The Right of Renewal is covered in the Agreement and it is common for a notice to require to be served on the Franchisor when the Agreement is renewed. This notice usually has to be served between three and six months before the end of the term, i.e. not in the last 3 months of the term and has to be properly served usually by first class or recorded delivery post usually to the Franchisor's registered office address. This is all detailed in the Franchise Agreement and if these terms are not clearly understood then a Franchisee could easily find that through a technicality he has no right to renew the Term and all the time and effort he has invested into his business in the first 5 years then counts for nothing.

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“...it is not unusual to find that if the Franchisee is convicted of a criminal offence...”

There are many detailed clauses in the Agreement telling the Franchisee what he must do to run the Business in accordance with the System and the directions of the Franchisor. The next longest section in the Agreement is the Termination clause which tells the Franchisee that the Franchisor can terminate the contract if the Franchisee commits a breach of the Agreement and the various examples of breach are highlighted in the Termination Clause. If a Franchisee does not have a clear understanding of these clauses then he can easily find that something which he considers to be relatively minor is sufficient for the Franchisor to terminate the Agreement and close down his business. By way of example, it is not unusual to find that if the Franchisee is convicted of a criminal offence (other than a road traffic offence not involving a jail sentence) that the Franchisor has the right to terminate the Agreement. I usually tell clients that I would consider this to be unfair if the Agreement was terminated because they had committed a breach of the peace. That is what I would consider to be a minor offence not in any way affecting the Franchise business perhaps occurring outwith business hours and yet this alone may give the Franchisor the right to terminate the Agreement with the Franchisee forfeiting his fee and losing his livelihood. I would suggest a revision which only allows termination in the event of an offence involving dishonesty or a conviction of a serious criminal nature. There are numerous revisions that a good Solicitor will recommend to the Franchisee in a report on the Agreement and thereafter the report is normally sent to the Franchisor with a request that these revisions be incorporated into a Side Letter for the benefit of the Franchisee. This is a letter which is personal to the Franchisee and that says that as long as he is the Franchisee of the business these matters will not apply to him. It is usual for a Franchisor to allow a number of these revisions provided they are not material points which alter the thrust of the Franchise Agreement itself.

“...Consider not who the Franchisor is today but to whom the Franchisor might sell the Business tomorrow...”

It is quite common for a Franchise Agreement to require the Franchisor's written consent on numerous occasions throughout the contract. A standard revision is that the Franchisor will behave reasonably when considering granting consent and give consent without delay. We call this “A Reasonableness Provision”. Otherwise the Franchisee might

have great difficulty in running his business if the Franchisor can simply withhold consent every time he is approached. Therefore a simple revisal such as this can make a major impact on the successful running of the business. Consider not who the Franchisor is today but to whom the Franchisor might sell the Business tomorrow thus leaving the Franchisee to deal with another party who is perhaps not as sympathetic or helpful in supporting the Franchisee.

The Franchise Agreement will regulate what happens upon the proposed sale of the Business by the Franchisee and usually the Franchisor has the right to buy the business back at the same price as any other offer that is made provided he agrees to do so within an agreed period of time which is usually four weeks. If the Franchisor does not want to buy the business back then any purchaser who wants to buy the Franchisee's business must comply with the Franchisors' standards and complete Training satisfactorily. The Agreement will also cover what happens to the business upon the death of the Franchisee or if the Franchisee is unable to run the business through incapacity. It is usual for the Franchisor to state that if the Franchisee cannot run the business for a defined period of time then the Agreement can be terminated. The Solicitor will check whether this period is reasonable and if not will propose a revisal to ensure that the Franchisee isn't off work with a cold for a couple of weeks and then finds upon his return that he no longer has a business. Whilst this is perhaps an extreme example, a couple of months is a normal period and the Franchisee simply needs to understand what he could be up against and to have his Solicitor propose revisals that make the Agreement more user friendly and the relationship more balanced between the Franchisor and the Franchisee.

“...As a Solicitor I will always try and explain the downside to a Franchisee and make him aware of what the worst scenario could be...”

As a Solicitor I will always try and explain the downside to a Franchisee and make him aware of what the worst scenario could be. A good solicitor is also a good businessman who understands the commercial aspects of the deal and who will outline both the upside and the downside to you and make sure that your downside is protected so far as possible. An Affiliated Solicitor of the British Franchise Association (and there are only 5 in Scotland) will have a good working knowledge of Franchising and what to expect in an Agreement. He will be able to tell you if you have a Standard Form of Agreement and will quickly identify any nasty provisions that should be rejected. Some of us are in a network when we e-mail each other to enquire if another BFA solicitor has had experience of a particular Franchisor and the Agreement for that Franchise and to ascertain how other Franchisees have been dealt with.

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Some of us are approachable and we honestly don't start the clock every time you phone or write to us. Our firm prepare a Franchise Report for £300 plus VAT and this includes usually a brief preliminary meeting and a full detailed follow up meeting sometimes lasting a couple of hours going through the report and highlighting and discussing all matters of relevance to the Franchisee.

I would be delighted to answer any questions or to speak with you on a one to one basis after the session has ended.

Thank you for your attention!

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