

A Franchisor's guide to taking the pain out of selling a franchise



At MacDonald Lewis Law we like to assist both franchisors and franchisees to make the process of selling and buying a franchise as painless as possible.

We have noticed some recurring issues which seem to arise with most franchise purchases. These issues cause hold ups in the process and end up costing both the franchisor and the franchisee more in terms of legal fees and time.

The most frustrating thing about these issues is that we believe the majority of them are easily fixed.

In this Information Guide, we will outline the major issue we have come across, and some practical tips of ways of dealing with them.

Most of the issues we see fall under the following headings:

PROCESS

- Does your prospective franchisee know exactly what they need to do and when?
- Consider providing your prospective franchisee with a guide/flowchart/time line.
- Make sure your prospective franchisee knows what they need to do at each stage and what you will be doing.

PEOPLE

- Make sure your prospective franchisee knows exactly who they will be dealing with and who they can contact if they have any issues/questions.
- Use your lawyers! The smoothest transactions we have come across are where the franchisor has used their lawyers right from the start.

- Refer your franchisees to well known and experienced franchise lawyers and accountants. Refer them to lawyers and accountants who have acted for your franchisees in the past.

INFORMATION

- What exactly is the deal? Record this in writing so everyone is on the same page. Provide this information to the franchisee's solicitor.
- What exactly is the franchisee getting?
- Provide a list of assets/equipment that the franchisee will be getting.
- What sort of training will be provided, when and for how long?
- For premises based franchises:
 - Who takes responsibility for the fitout?
 - What is the franchisor's role?
 - What is the franchisee's role?
 - Is there a fitout agreement?
 - What liability does the franchisor/franchisee have in respect of the development?
 - What happens when things go wrong? e.g. delays, cost blow outs
 - Insurance – who is responsible for this during fitout?
 - Who will be entering into contracts with the subcontractors?
- Provide a list of franchisees who are able to be contacted.
- Make the manual available for review (at an early stage).
- Marketing Fund – provide details of recent expenditure and proposed expenditure. What marketing/ promotional activities will you be conducting to promote the opening and

ongoing? What obligations does the franchisee have?

- Provide the franchise documentation at an early stage
- Provide information for the franchisee's accountant to review
- Website – if products can be purchased by customers via a central website run by the franchisor how will this affect the franchisee?
- Approved Suppliers – who are they and what are their terms? Are products supplied by the franchisor or an associate of the franchisor and if so what rights are there to increase products?

MONEY

- Exactly how much money does your prospective franchisee need? Provide a breakdown of costs.
 - Initial franchise fee
 - Initial marketing costs
 - Site Development fee and consent fee (if appropriate)
 - Training costs
 - Rental bond or guarantee
 - Rental deposit
 - Amount required for initial stock
 - Legal costs
- When are payments required?
- Who is holding the deposit and if and when is it refundable? See below for FANZ requirements if deposit required prior to franchisee becoming bound under the agreement.
- Is the price fixed, capped or not?
- What about budget blow outs? How much extra should a franchisee have in reserve?
- Has your system received accreditation from the major banks?

FANZ CODE OF PRACTICE

- If you are a FANZ member, be aware of the following:
 - Disclosure Document to be provided to the Franchisee at least **14 days prior** to prior to the franchisee signing a franchise agreement

or before the franchisee becomes bound under an agreement to proceed.

- If you are operating under a Master Franchise Agreements - Disclosure Document must fully disclose implications if Master Franchise Agreement is terminated.
- Make sure you franchisee gets a copies of the FANZ Code of Practice and Code of Ethics at least **7 days prior** to the franchisee signing a franchise agreement or before the franchisee becomes bound under an agreement to proceed. Also applies if franchisee is buying an existing franchise business.
- If your franchisee is required to pay money prior to signing, you must specify in writing:
 - the purpose for which the money is required; and
 - the terms and conditions governing the refund/application of such moneys; and
 - the identity of the person holding the money.

MISREPRESENTATIONS

- A claim that a franchisor has made a misrepresentation is the main theme in any litigation between a franchisor and franchisee
- Steps to prevent any claim:
 - do not provide projections
 - use comprehensive disclaimers
 - record all verbal representations in writing;
 - take files notes of all interviews, telephone calls and meetings;
 - require the franchisee to sign a Deed of Prior Representation.

CONSUMER LAW REFORM BILL

- This is the biggest reform of consumer legislation and is on track to become law early next year. One of the biggest changes is a prohibition on unsustainable representation.

- You will be prohibited from making any representation unless you can prove you have good grounds for making them.
- The burden for proof will be on you.
- Must be able to substantiate any representation made – not enough to say it is true.
- Substantial fines – up to \$600,000 for a company, \$200,000 for an individual and banning orders.

THE PAPERWORK

- What documents will the franchisee need to sign?
- Ensure the franchisee receives these at an early stage.
- Understand your documents – get the details right! Make sure the company names are correct.
- Know the issues which franchise lawyers might raise and have answers for them.
- If the agreements have come from overseas – make sure they are tailored to suit current New Zealand conditions.
- Keep your agreements as simple as possible.
- Get your lawyers to review your documents every 2 to 3 years to ensure they are current.
- If you take a GSA - think about priority issues.

THE FRANCHISE AGREEMENT

What is particularly important for franchise lawyers:

- Franchise Term – how does this stack with the lease term?
- Does the agreement identify where you get your right to the IP?
- If you are a master franchisor/franchisee or licensee what happens if this master licence ends?
- Are your obligations adequately defined in the agreement?
- Is the marketing fund properly identified and how does it operate? What information can a franchisee expect to receive?

- Territory – is it exclusive and are there any circumstances in which exclusivity can be reduced or removed? Can the franchisee market outside the territory? Are you able to purchase competing brands in the territory?
- What are the obligations of the franchisee and are they well defined?
- Can you increase the fees?
- What provision is there for ongoing training and conferences and who pays what?
- How does the agreement deal with any lease of premises and the fitting out of premises?
- Restraints of trade? Are these reasonable?
- What are the default provisions?
- Is there adequate dispute resolution procedure?
- Is the schedule in the agreement properly completed?

Clauses we don't like:

- The ability of franchisor to increase fees during the term
- Inadequate description of the obligations of franchisor
- Unfair sudden death clauses for defaults
- Long winded and poorly drafted clauses that don't make sense.
- Over the top restraint provisions.
- Franchisor discretion to add additional transfer conditions.
- Territories which are stated to be exclusive but in reality are not.
- Franchisor discretion to amend a territory.
- Franchisor ability to demand refurbishment at any time.

THE LEASE

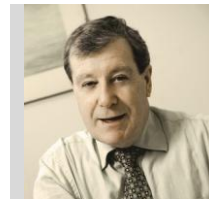
- If there is a lease already in place make sure this is made available to the franchisee at a very early stage.
- Be very clear on what the landlord's requirements will be re approvals, rental deposits and bank guarantees.
- Who is paying the landlord's fees?

- If the lease is still being negotiated – keep the franchisee informed, give the franchisee an opportunity to review the Agreement to lease before it is finalised.
- Facilitate introductions between landlords and the franchisee.
- If the franchisee is negotiating the lease make sure it knows your requirements e.g. provide details of any clauses you require to be in the lease at an early stage.
- Try to negotiate the following clauses in to the Agreement to Lease:
 - exclusivity
 - no requirement to pay landlord's legal costs
 - automatic return of bank guarantee/ release of guarantors on assignment
 - sunset dates – re obtaining consents and commencing the development
 - extended trading hours
 - landlord approval not required for assignment to a franchisee
 - fitout period during which no rental/ outgoings payable
- Make sure the Agreement to Lease is very specific on the landlord's fitout requirements and when these are to be completed.
- If a bank guarantee or bank bond is required, make sure the franchisee knows this at an early stage and that the form of the bank guarantee is

agreed on by the landlord **prior to entry into ATL.**

SUMMARY

Franchisors who are organised and provide timely and comprehensive information to franchisees avoid misunderstandings and delays throughout the process leading up to the commencement date. Franchisees need a lot of hand holding at the initial stages to ensure that they get off to a good start and franchisors need to ensure that they present their requirements in a proactive and clear manner that avoids misunderstandings and delays.



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