

The franchise agreement: understanding what you are letting yourself in for.



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If you take a franchise you are likely to be asked to sign an agreement that is at least 30 pages long. Unless you have some experience of business, the franchise agreement will be different from any that you have ever signed before. Unlike employees and consumers there is no special statutory protection for franchisees. This agreement will have been drafted by lawyers for the franchisor with instructions to protect their client's interests. It will therefore cater for the franchisor's interests and not yours. Save for such variables as the boundaries of the territory and payments to the franchisor there is very limited scope for negotiation. You take the franchise or leave it.

Independent Legal Advice

Before signing the agreement you will be encouraged by your franchisor and bank to instruct a lawyer to review the agreement. This review is as much for their protection as it is for yours. The reason the franchisor and bank want you to take independent legal advice is that one of the defences to a claim for breach of contract is that the defendant did not properly consent to the agreement because he or she felt under pressure to sign it. If the agreement has been read and explained to you by your lawyer it is much harder to rely on that particular excuse.

Most lawyers with experience of franchising will charge about £400 plus VAT to review and report on the agreement. They can do the work for that fee because they have seen the same or similar agreements many times before and they know what to look for. Lawyers with less experience of

franchising may actually charge more because they will require more time to read and understand the draft. Also, they may be tempted to enter a fruitless correspondence with the franchisor or its lawyers for amendments that the franchisor will have been advised not to concede. A more experienced lawyer will know better than to do that. You will usually have to pay for that work.

The value of the review for you is to warn you of the risks you will incur if you accept the agreement. It should be one of several factors that enable you to decide whether or not can make a success of the venture. You will probably also need advice from other professionals such as accountants and specialist consultants.

Applicable Laws

As there is no specific legislation for franchising in England and Wales, the general law of contract will apply to your franchise agreement. Most of the law of contract is common law – that is to say principles derived from decisions of the judges of England and Wales and other English speaking countries over several centuries – but it is supplemented by a number of statutes of which you should be aware. These include the:

- **Misrepresentation Act 1967:**¹ this statute regulates statements of fact made by one party to a contract to another before the contract is concluded;
- **Unfair Contract Terms Act 1977:**² this limits the extent to which one party to a contract can limit his or her liability for negligence and breach of contract by reliance on his or her contract terms;
- **Trade Marks Act 1994:**³ this provides for the registration and licensing of trade marks; and
- **Competition Act 1998:**⁴ this regulates agreements that prevent, restrict or distort competition or abuse a dominant position.

There was for many years a specific franchising block exemption. The reason you need to know that this legislation is that agreements were drafted to meet its requirements. The regulation continues to influence the drafting of franchise agreements even though it has long been replaced by a general vertical agreements block exemption.⁵

Should you decide to take the franchise, you will have to learn about banking, company, consumer credit, consumer protection, data protection, e-commerce, employment, intellectual property landlord and tenant, planning, supply of goods and

¹ 1967 c 7 <http://www.legislation.gov.uk/ukpga/1967/7>

² 1977 c 50 <http://www.legislation.gov.uk/ukpga/1977/50>

³ 1994 c 26 <http://www.legislation.gov.uk/ukpga/1994/26>

⁴ 1998 c 41 <http://www.legislation.gov.uk/ukpga/1998/41>

⁵ 1998 c 41 <http://www.legislation.gov.uk/ukpga/1998/41>



services and tax law - just like any other small business - but that is for another day.

Reaching your Decision

The reason for taking a franchise is that the franchisor has developed a business under a brand that appears to attract consumers. If you want to trade under his brand you need the franchisor's permission. The franchisor will grant you that permission only upon a number of conditions. Some of those conditions may be quite burdensome but they are necessary for the preservation of the franchisor's business. That is why there is very little scope for negotiation.

Franchising is not for everyone as I say in my articles *Taking a franchise may be the best thing you ever do*⁶ and *Franchising*⁷. On the other hand, the British Franchise Association states on its website that about 90% of all franchisees reported profitability over the last 12 months and the banks are very supportive.⁸ I never try to put a client off franchising when I review a franchise agreement though I never pull any punches if the agreement contains unusual or oppressive clauses. I always make sure that the client knows exactly what he or she is letting him or herself in for.

What is in a Franchise Agreement?

A typical franchise agreement will include the following provisions:

- **Parties:** the names, addresses and other particulars of the franchisor, franchisee and guarantors (if the franchisee is a limited company);
- **Recitals:** a number of lettered or numbered paragraphs setting out the context of the agreement such as the franchisor's trade mark registrations, the business that it has developed and the franchisee's desire to accept a franchise;
- **Interpretation:** a list of defined words and phrases and other provisions for the interpretation of the agreement;
- **Grant:** a licence to carry on the franchisor's business often in a space known as "the Territory" under the franchisor's trade marks for a term;
- **Consideration:** usually an initial fee, contributions towards training, marketing and other expenses and a periodic payment or royalty;
- **Term:** usually a renewable term of 5 years;

- **Manuals:** incorporation of the operating and other manuals into the agreement;
- **Franchisor's Obligations:** generally to provide training and a manual, protect the intellectual property and supply merchandise, advertising and technical support;
- **Franchisee's Obligations:** to complete the training, carry on the business diligently in accordance with the manual, punctually meet all periodic payments and contributions, keep full and accurate records and allow the franchisor's accountants to inspect them, comply with all applicable laws, observe all standards, report all IP infringements to the franchisor and co-operate in enforcing its IP rights, contribute towards advertising, not to use or disclose confidential information and many, many more;
- **Default Notice:** notice from the franchisor specifying a breach with a request to remedy it or pay compensation within a specified time;
- **Termination:** the circumstances in which a franchisor can terminate the franchise such as repudiation of the contract by the franchisee or death, incapacity or insolvency;
- **Consequences of termination:** these usually include drawing up accounts, payment of moneys due to the franchisor and restrictions on the franchisee's freedom to run a competing business;
- **Sale of Franchise:** conditions for the sale of a franchise;
- **Force majeure:** suspension of the franchisor's obligations should its performance be prevented or delayed by circumstances outside its reasonable control such as strikes, natural disasters, war or civil unrest;
- **Severance:** disregarding provisions that are found to be void or unenforceable without invalidating the remaining clauses;
- **Whole agreement:** a statement that all the terms of the agreement are contained in or incorporated into the document
- **franchisee's acknowledgement** that he or she did not enter the agreement in reliance rely on any statement of fact or opinion by the franchisor;
- **No waiver:** no act of indulgence by the franchisor will constitute waiver or abandonment of its rights or remedies;
- **Notices:** provisions for serving notices and notifications;
- **Dispute resolution:** provisions for the resolution of disputes; and
- **Proper law:** the laws by which the agreement will be construed and enforced.

⁶ Jane Lambert 2 Oct 2011 at <http://nipclaw.wordpress.com/2011/10/02/taking-a-franchise-may-be-the-best-thing-you-ever-do/>

⁷ Jane Lambert 24 July 2010 at <http://nipclaw.wordpress.com/2010/07/24/franchising/>

⁸ <http://www.thebfa.org/join-a-franchise/advantages-and-disadvantages-of-franchising>

You are unlikely to see a sample franchise agreement until after you have passed your franchisor's initial screening. Franchisors do not tend to publish them. However, you can get some more information on what they contain like from



Business Link's *Tips on Franchise Agreements*⁹ and whichfranchise.com's page on franchise agreements.¹⁰ Also, you can get some idea of what franchise agreements look like by reading some of the American agreements that have been filed with the US Securities and Exchange Commission.¹¹

Whole Agreement Clause

All the litigation between franchisors and franchisees in which I have been instructed has come about because the franchisee believed that he or she had been misled by the franchisor. Disappointed franchisees often point to passages in the franchisor's brochure or website or promises or assurances allegedly given in preliminary interviews. Such statements are invariably denied or explained away by other evidence showing that the franchisee had already made up his or her mind to accept the franchise come what may. "Whole agreement" clauses, acknowledgements that neither party relied on statements of fact or opinion of the other and similar exclusions add to the franchisee's difficulties. It is therefore unsafe to rely on anything that a franchisor says to you that is not within the contract.

When I am asked to review a draft agreement I ask the client for his or her understanding and expectations of the agreement. Where appropriate I ask to see copies of any correspondence or promotional literature that the client has received. My report can therefore highlight any differences between the client's expectations and the terms of the contract.

Sometimes a franchisor responds to a client's concerns with a side letter or some other assurance. Franchisees should treat such letters with enormous caution. Unless they are specifically incorporated into the franchise agreement they may also be caught by the "whole agreement" or other exclusion clauses. Furthermore, any substantial concession by a franchisor suggests lack of confidence or some other weakness on the part of the franchisor which is not a good sign.

The Operations Manual

Most franchise agreements incorporate the franchisor's operations manual into the contract. The manual usually imposes further obligations and restrictions on the franchisee thereby effectively extending the contract. Whenever possible the franchisee should ask to see the manual before signing the franchise agreement. However, franchisors are not always willing to disclose their manuals before contract. Their reluctance is

⁹ <http://www.businesslink.gov.uk/bdotg/action/detail?itemId=1073791406&type=RESOURCES>

¹⁰ <http://www.whichfranchise.com/mobile/resources/article.cfm?featureId=26#/mobile/resources/article.cfm?featureId=239>

¹¹ <http://www.onecle.com/>

understandable because the manual is likely to contain sensitive technical and commercial information. Franchisees should still be cautious even if they do see the manual because the manual can be changed at any time at the discretion of the franchisor.

Terminating the Franchise

I am often asked by a client how he or she can get out of a franchise agreement if it turns out badly. Most franchise agreements provide for termination by the franchisor only. The circumstances in which a franchisor would want to terminate an agreement include cases of serious or persistent breaches of contract and the franchisee's death, insolvency or incapacity. For most franchisees who want to get out, the best option is to sell the franchise. However, a sale almost invariably requires the consent of the franchisor and the franchisor is unlikely to give its consent if it is owed money or the franchisee has breached the contract. Also, it is difficult to attract a buyer unless the franchise is a going concern. Prospective purchasers, including members of the franchisee's family, must satisfy the franchisor's recruitment criteria. They must be prepared to undergo training and pay the franchisor's legal costs and other expenses. Often the retiring franchisee remains liable to the franchisor for any losses arising from the acts or defaults of the incoming franchisee for the remainder of the franchise term.

If the franchise is terminated by the franchisor the franchisee stands to lose his or her investment in the business. Also, he or she remains liable to the franchisor for any accrued and sometimes future periodic payments. Finally, he or she may be subject to restrictions as to the sort of business that he or she can carry on after termination of the franchise though some of those restrictions may not be valid. Disputes over all these matters often lead to litigation which the franchisee can barely afford.

A prudent franchisee will plan for these possibilities from the start. In particular, he or she will take out insurance against his or her legal and other expenses where that is possible.

Intellectual Property

The franchise depends on the strength of the franchisor's trade marks and other intellectual property. It is always worth checking the Intellectual Property Office's registered trade mark and designs databases to make sure that the franchisor is the proprietor or otherwise entitled to those marks. It is also worth enquiring whether the franchisor has the means and inclination to pursue infringers if that needs to be done. The lawyer who reviews your draft franchise agreement should have experience not only of franchising but also of intellectual property litigation.



Further Information

Franchising is a complex topic and this article is by no means exhaustive. If you wish to discuss any of these issues or franchising generally, you should not hesitate to call me on **0800 862 0055**.