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COMMERCIAL LAW

# 10 Tips For *Buying a Franchise*

# *Buying a franchise can be a great way to get into business for yourself.*

**It eliminates much of the uncertainty and risk of a traditional start-up.**

Capitalising on an established brand's model and reputation means you can hit the ground running. It's an exciting endeavor with the potential to reward you and your family for years.

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# *The foundation of any successful franchise is the relationship between the franchisor and the franchisee.*

**The terms of your relationship are established in the franchise agreement — a 40 - 80 page document covering a wide range of legal topics — presented to you by the franchisor.**

It's crucial to review this agreement thoroughly, bearing in mind that at this point the franchisor is a salesman.

Take your time reviewing the franchise agreement and operating manuals. Be sure you understand everything before signing on the dotted line and don't emotionally commit without thorough due-diligence. Of course we recommend consulting a lawyer who specialises in franchising. They know what's reasonable and what constitutes a red flag in these complex agreements. It will save you time now and surprises down the track.

# *Franchise agreements.*

**Though individual franchise agreements vary widely, our experts were able to break down ten things they should all include and what to look out for in each:**

## **1. Franchise manual**

*Your business bible.*

The manual should provide all the tools necessary for a turn-key operation. Does it fully prepare you for Day 1? Is the information contained within the manual complete, up to date and easily understandable? Who prepared the manual and who is responsible for ensuring that it is updated regularly? Compliance with the manual is almost always a term of the franchise agreement, so it's important to view and understand it before signing.

## **2. Length of the Franchise**

*Protecting yourself on the back-end.*

Often we find franchise agreements will state that there is a right of renewal but the way the clause is written can mean that it is not automatic and is actually quite discretionary. Your lawyer will need to check this, especially if your bank is relying on the term being of a specific length. If the branding or trade-marks change, are you obligated to update your business to the current image? Can the franchisor renegotiate the franchise area upon renewal and, if so, can the franchisor reduce or enlarge it? What is the likelihood of that happening?

### **3. Territory**

*Don't get squeezed out.*

Does the franchisee get exclusive rights to a territory for the length of the agreement or can this be “diluted” at some stage, for example, if the franchisee is not performing? Also, can the franchisor refer work to another franchisee if it considers that you are not in a position to satisfy customers’ needs? You should ask the franchisor to outline the decisions and assumptions upon which the territory has been determined and selected.

### **4. Premises Lease**

*Our advice: read this section carefully and then read it again.*

Does the franchisor take the head lease and sublet to the franchisee, or does the franchisee lease the premises? If you sublease, you need to ensure that the term of the head-lease (including any renewal) closely mirrors and corresponds to the term of the franchise agreement, as your sub-lease will be based on the term outlined in the head-lease. Also, is the length of the lease the same as that in the franchise agreement? They should be the same to avoid you paying rent even after the franchise agreement has terminated. Likewise, you do not want to have a franchise but no premises to operate from.

## **5. Does the franchisee have to buy products or supplies from the franchisor?**

*The nuts and bolts of the agreement. (Or bread and butter as the case may be)*

What are the terms and conditions of supply if they are not included within the franchise agreement? Issues that are relevant include: time for delivery, notice required when placing orders, whether you will be required to insure the goods in transit, when risk passes and, how long you will have to inspect and return any products that are defective. Will the franchisor warrant that the products are of a consistent good quality and standard? Also, are the products being sold to you at a reasonable price, so that you are able to make a margin on the subsequent sale?

## **6. Does the franchisor have minimum performance criteria?**

*Are the expectations grounded in reality?*

Are the criteria achievable and are the current franchisees meeting them? How is the minimum performance criteria set and how often is the criteria reviewed? Do you have input into the review process?

## **7. What is the procedure if you wish to sell the business?**

*Don't lose your investment to hidden fees.*

Do you have to firstly offer the business back to the franchisor? If so, you should note the time frames within which the franchisor is required to exercise its right. If the franchisor does not exercise its right and you sell to a third party, does the franchisor charge a transfer fee and what approval is required? What extra costs are you required to pay e.g. Landlord's consent costs, franchisor's solicitor's costs, training costs and referral costs?

## **8. How can the franchise agreement be terminated?**

*Know your rights.*

Reasons for termination need to be considered carefully. Can the agreement be terminated if you change the controlling interest in the franchisee company? If so, you should obtain confirmation from the franchisor that where the shares are being transferred to a trust, the franchisor will not unreasonably withhold its consent.

## **9. How are disputes resolved?**

*Is there a clear path to common ground?*

There is no legislative procedure to follow for resolving disputes between franchisors and franchisees in New Zealand. It's best if your franchisor has voluntarily joined the Franchise Association of New Zealand and follows the Code of Ethics and Code of Practice espoused by FANZ as best practice. If not, is there an alternative dispute resolution procedure laid down in the agreement?

## **10. Non- Competition**

*Don't assume they won't enforce it.*

Non-competition clauses need to be carefully reviewed to ensure only reasonable restraints are imposed at the end of the franchise. Some matters to consider: Are you (and any directors/shareholders of the company that you run the franchise through) restrained from operating a similar business in competition with the franchisor? If so, how long does the restraint last for and what is the territory that it covers? Does the restraint also prevent you from working in the same industry as an employee when the franchise ends?

Once you've thoroughly read and understand your franchise agreement, you should consider carefully the potential responsibilities, restrictions and reward.

*If you decide to buy, you've done so with your eyes open.*

Now you're free to focus on working hard and making your business a massive success.

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