

Negotiated Franchise Agreements

Similar to the Fram™ oil filter campaign circa 1971, “You can pay me now or you can pay me later” franchisors that elect not to negotiate franchise agreements up front run the risk of negotiating them forever.

A key to successful personal and professional relationships is saying hello and goodbye with equal aplomb. Franchise relationships however, typically start off lopsided and terminations rarely receive much fanfare. Franchisors that do not embrace negotiation prior to agreement signing fail to improve upon this dichotomy.

Independent business owners freely engage in negotiation when establishing relationships and contractual agreements. Generally, the greater the value or complexity of business dealings, the more apt negotiation is to be employed in the process. Negotiation has thus earned distinction as a best practice and stood the test of time.

Franchisors have traditionally eschewed negotiation in the award of franchises. Given franchising’s potential value and complexity, lack of negotiation is conspicuous by its absence. Franchisor rationale for such practice includes the dubious assumptions that non-negotiable franchise agreements enhance control and reduce costs.

Franchise agreements that are not negotiable can inadvertently discourage qualified investors from considering franchising as an option and influence the adverse selection of franchisees that ultimately prove unsuitable. Disputes that erupt between the parties all too often result in franchisees resorting to legal means to compel negotiation of franchise agreements up to years after signing. Franchisee justification for such actions emanates from failures, and from perceptions that the business model, the franchisor, or both, failed to meet expectations at some point. A more plausible explanation however, is that prospective franchisees, in the absence of negotiation, may be less able or willing to walk away from offerings they do not initially recognize as ill-fitted. Although much can be ascertained about franchise offerings in advance, a lack of negotiation can deprive both parties of the opportunity to more thoroughly understand offerings, obligations, consequences and each other.

Thus, the questions before all franchisors should be; *“to what extent will up front negotiation help to reduce or eliminate disputes that may escalate into forced negotiation well after agreement signing?”* and, *“what terms, conditions and pricing are best negotiated in advance of agreement signing?”*

Franchisors need not rush into negotiating franchise agreements all at once. Best practices suggest starting with the selective negotiation of points that mutually represent the partys’ legitimate business interests, and as warranted, expanding the list at the time of periodic franchise disclosure document filings.

If your franchise award program does not currently enjoy negotiation, now is the time to evaluate the cause and effect of negotiating vs. not negotiating a variety of terms, conditions and costs, which hold the greatest potential to help the franchisor and its franchisees achieve the success they desire.

Top ten reasons for negotiating franchise agreements prior to signing:

1. Potential to attract a broader range of qualified franchisee investors.
2. Positive differentiation of the franchise offering from non-negotiable competitor offerings.
3. Potential to mitigate disputes that result in protracted negotiation years after agreement signing.
4. Proven methodology for revealing partys’ positions and rational, through discussion of issues that have most profoundly impacted franchisor/franchisee relationships over time. Negotiations appearing unreasonable or not conducted in good faith may be indicative of behaviors to be expected throughout the relationship.
5. Promotes franchisees’ use of third party licensed professional advisors due to the fact that there are legal and financial terms to be negotiated to the mutual benefit and satisfaction of the parties and their representatives.
6. Enhances franchisees’ understanding of agreement terms, conditions, obligations and consequences.
7. Flexibility to accommodate diverse franchisee abilities, finances, goals and preferences as well as competitive, economic, demographic and geographic target market variations.
8. Extended time between disclosure and agreement signing to help lessen the effect of emotion on prospects’ decisions to become franchisees and franchisors’ decisions to award franchises.
9. Ongoing opportunity for franchisors to incrementally improve franchise agreements based on market driven input from a broad cross section of prospects and their licensed professional advisors.
10. Relieves franchisor sales staff of the role of company apologist for non-negotiable terms and conditions.

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Franchise agreement terms, conditions and costs for suggested evaluation of negotiation potential:

Fees and costs:

- ▶ Attorney fees
- ▶ Convention fees and costs
- ▶ Dispute resolution fees
- ▶ Financial penalties
- ▶ Financial records
- ▶ Franchise holdover fees
- ▶ Indemnification costs
- ▶ Inflation adjustment
- ▶ Franchise fee, initial
- ▶ Franchise fees, other
- ▶ Interest rates
- ▶ Late payment fees
- ▶ Late reporting fees
- ▶ Liquidated damages
- ▶ Refurbishment costs
- ▶ Renewal fees
- ▶ Royalties
- ▶ Sanctions
- ▶ Technology fees and costs
- ▶ Territory fees
- ▶ Training fees and costs
- ▶ Transfer fees
- ▶ Value of intellectual property
- ▶ Value of inventions
- ▶ Value of patents

Dispute resolution:

- ▶ Arbitration
- ▶ Attorney fees
- ▶ Choice of law
- ▶ Damages
- ▶ Indemnification
- ▶ Injunctive relief
- ▶ Jury trial
- ▶ Jury trial waiver
- ▶ Limitation of claims and actions
- ▶ Limitation of damages
- ▶ Liquidated damages
- ▶ Mediation
- ▶ Venue
- ▶ Waiver of rights

End of term options:

- ▶ Close and cease operation
- ▶ Franchisee buy out
- ▶ Franchisee sale to existing franchisee
- ▶ Franchisee sale to franchisor
- ▶ Franchisee sale to new franchisee
- ▶ Franchisor acquisition option
- ▶ Non renewal
- ▶ Prior notice of termination
- ▶ Renewal conditions
- ▶ Renewal options

Exclusive sales and/or unit location territories:

- ▶ Competitive variations
- ▶ Demographic variations
- ▶ Economic variations
- ▶ Formula for assessing
- ▶ Geographic variations
- ▶ Internet sales
- ▶ Market protection
- ▶ Minimum performance requirements

Miscellaneous:

- ▶ Alternate suppliers
- ▶ Automation options/requirements
- ▶ Confidentiality
- ▶ Cross defaults between agreements
- ▶ Expansion options
- ▶ Facility Leases/Subleases
- ▶ Franchisee’s continuing personal guarantee
- ▶ Furnishings, fixtures and equipment options
- ▶ Internet presence
- ▶ Non-competition in term & after termination
- ▶ Personal guarantees
- ▶ Release of prior claims
- ▶ Relocation options
- ▶ Signatories

Term and termination of franchise agreement:

- ▶ For cause, curable
- ▶ For cause, non-curable
- ▶ Term length, initial
- ▶ Term length, renewal
- ▶ Transfer approval/refusal rights
- ▶ Voluntary termination

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Termination triggers and events:

- ▶ Abandonment
- ▶ Absence of signed confidentiality agreements
- ▶ Audits and site inspections - failure to comply
- ▶ Bankruptcy or declaration of insolvency
- ▶ Breach of in-term non-compete covenants
- ▶ Bringing disrepute or unfavorable public view
- ▶ Chronic insufficient inventory or production
- ▶ Chronic late/non-payment of monies due/owing
- ▶ Criminal conviction
- ▶ Cure provisions
- ▶ Death, disability or incompetency
- ▶ Failure to devote sufficient time and resources
- ▶ Failure to maintain min. performance levels
- ▶ Failure to open within designated time period
- ▶ Failure to successfully complete training
- ▶ Felony conviction
- ▶ Franchisee request to terminate without cause
- ▶ Fraud
- ▶ Goodwill impairment
- ▶ Maintaining false or misleading books/records
- ▶ Material misrepresentation
- ▶ Misuse of trademarks and/or copyrights
- ▶ No insurance or lapse of insurance
- ▶ No trained manager
- ▶ None or submission of false financial statements
- ▶ Notices
- ▶ Poor quality or workmanship
- ▶ Repeated material defaults after cure
- ▶ Sale of sub-quality products and services
- ▶ Sale of unauthorized products and services
- ▶ Submitting false or misleading reports
- ▶ Substandard appearance of facilities
- ▶ Substandard cleanliness of facilities
- ▶ Substandard maintenance of facilities
- ▶ Tax delinquency and/or failure to timely remit
- ▶ Termination or non-renewal of facility lease
- ▶ Unauthorized closure for X number of days
- ▶ Unauthorized closure, permanent
- ▶ Unauthorized disclosure of confidential info
- ▶ Unauthorized transfer of business
- ▶ Unauthorized transfer of franchise agreement
- ▶ Unfair competition
- ▶ Unsanitary conditions
- ▶ Unsatisfactory client relationships
- ▶ Unsatisfactory supplier relationships
- ▶ Violation of federal and state anti trust laws

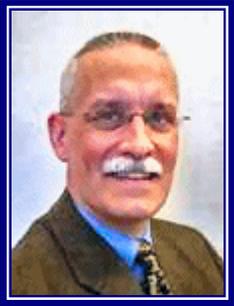
Note: Franchisors are strongly advised to consult licensed professional franchise attorneys on the appropriateness, legality and disclosure language related to any franchise agreement terms, conditions and pricing designated for negotiation, in order to remain fully compliant with the FTC Franchise Rule and with state franchise registration laws.

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About the Author:

Bob Snelling is president and founder of Honor Capital Group, LLC a small business consultancy and finance intermediary, and the author of Tip Top Docs brand of professional business documents.



Bob’s diverse business experience spans multiple industries dealing with products, services and people. Serving as an employee in various positions from warehouse to boardroom Bob has directly reported to no less than five extraordinarily different company presidents. As a business owner making decisions, setting budgets, and meeting payrolls for up to thousands of employees, Bob has known first hand what it is to maintain legal, operational and P & L responsibility. Performing in the roles of senior level executive, CEO, board director and major shareholder of Snelling and Snelling, Inc., a national, and for many years international company with hundreds of franchised and corporate units, Bob has by necessity perfected leadership skills that are tolerant and respectful of widely divergent perspectives.

A unique background with progressive levels of operational, managerial and financial responsibility has proved invaluable preparation for Bob’s current role as business advisor and finance intermediary. Guided by ethical behavior, attention to detail, and a regimen of planning, collaboration and teamwork, Bob's innovative yet practical solutions consistently deliver return on investment and stand the test of time. Decades invested in the identification and implementation of sustainable best practices uniquely qualifies Bob to author relevant topics that today’s franchised and independent business leaders can immediately benefit from and put into action.

Bob currently resides in Plano, Texas a suburb of Dallas with his wife and business partner Carol, their two children and a Border terrier. e-mail: bob@HonorCapitalGroup.com phone: (972) 735-0005