

# WHAT YOU NEED TO KNOW BEFORE BUYING A FRANCHISE

Many of prospective franchisees have the same questions when they first consider purchasing a franchise. These include the following:



Julie Lusthaus

## What is franchising?

Franchising is a method of expanding a business where the franchisor licenses its trademark and business system to a franchisee. In exchange, the franchisee pays a fee. Franchisees then conduct their business in accordance with the franchisor's standards and specifications. Franchisors also typically provide franchisees with pre-opening training, post-opening training and overall support.

## What are the advantages of franchising?

When you purchase a franchise, you are buying a proven business system. Franchisees get to tap into the franchisor's knowledge of how to best operate its business, which saves time and cuts down on mistakes. In addition, franchisees receive training, ongoing support and assistance. Some franchisors also create advertising programs which provide maximum exposure for its franchisees.

## What types of franchises can be offered?

Generally, franchises either operate in the retail sector or the service industries. Retail franchisors may offer, among other options, full retail store franchises, kiosk franchises, or store-in-a-store franchises that offer all product lines, one product line or a combination of the product lines. Service franchises can offer a full assortment of services, one specific service or a combination of services. The types

of franchises that may be offered are as unique as the particular business model developed by the franchisor.

## What is a Franchise Disclosure Document (FDD)?

Before a franchisor is legally permitted to sell a franchise, it must comply with certain rules promulgated by the Federal Trade Commission (FTC) and/or statutes enacted by the state the franchisor is selling from or the state the franchisor is selling into. The purpose of the rules and/or statutes is to require the franchisor to provide the potential franchisee with information to make an informed decision about purchasing the franchise. The FTC Rule requires franchisors to provide potential franchisees with a Franchise Disclosure Document (FDD). When deciding whether or not to purchase a franchise, it is best to have advisors, such as an attorney with experience in franchises, review the FDD.

## What kind of information is in an FDD?

The FDD contains 23 separate items of information. It is similar to a stock prospectus in that its purpose is to provide sufficient accurate information for prospective franchisees to make an informed investment decision. Among other things, the franchisor must provide a company history; information about the types of products offered and the general condition of the marketplace; a description of the initial franchise fees and



Mackenzie Dimitri

# NOW FRANCHISE

all other fees paid during the course of the franchise relationship; a description of the assistance the franchisor will supply; and an explanation of the system standards for advertising development and placement, site selection and build out, and computer systems. The FDD will also detail the size and scope of the territory granted to the prospective franchisee and will discuss the rights retained by the franchisor. Franchisors may choose to disclose information relating to the financial performance of the franchise system or franchisees operating within the system.

## What are the more common areas for dispute that arise during the franchisee-franchisor relationship?

There are seven common issues that arise between franchisors and franchisees, which relate to termination of the franchisee and enforcement of the post-term obligations, statutory compliance issues, fraudulent practices, intellectual property matters, territorial encroachment and general contract disputes. Many termination cases are brought by the franchisee in response to an improper termination of the franchise. Disputes arising from the franchisor's failure to comply with registration, disclosure, relationship laws or other federal and state regulations are also common. Franchisees may also bring claims alleging fraud and misrepresentation by the franchisor, including fraudulent statements made by the franchisor relating to potential earnings (referred to as 'earnings claims'). Other disputes may center around the franchisor's failure to comply with the franchise agreement by encroaching on



"When you purchase a franchise, you are buying a proven business system."

the franchisee's territory, failing to provide support or failing to comply with other requirements imposed by the franchise agreement.

## What things should I do before I purchase a franchise?

All prospective franchisees should conduct due diligence before purchasing any franchise. Compare franchising opportunities within the industry to determine which franchise is best suited for the prospective franchisee and which franchise may be the most successful. Once you have chosen to purchase a particular franchise, speak with as many franchisees in that system as possible, including former franchisees. Reviewing the FDD and offering with franchise counsel and an account is also an invaluable part of the due diligence process.

## Are franchise agreements negotiable?

Franchisors will often say the franchise agreement is non-negotiable, but there

is no steadfast rule. In truth, some franchisors are willing to negotiate, and certain terms are typically more negotiable than others. Generally, whether or not the franchisor is willing to negotiate terms — and if so, which ones and to what degree — is a matter of leverage. Factors may include how long the franchisor has been in operation, the size and scope of the franchise system, how eager the franchisor is to sell a franchise, and the extent of the franchisee's business experience or financial backing.

**Attorney Julie Lusthaus is a partner in the firm of Einbinder & Dunn, LLP. She focuses her practice in the area of franchise law, serving as counsel to both franchisors as well as franchisees. She can be reached by phone at 212-391-9500 or 914-705-5417 and via email at [jcl@ed-lawfirm.com](mailto:jcl@ed-lawfirm.com).**

**Mackenzie Dimitri is an associate attorney practicing franchise law and related litigation on behalf of franchisors and franchisees at Einbinder & Dunn, LLP in New York City.**