

# Buying a Franchised Business

By Matt Joyner, Esq.

In the current recession many people are interested in owning their own business as a way to free themselves from the uncertainties of corporate employment and to gain more control over their financial destinies. Often however they have little prior experience in starting a business. In these circumstances the choice to purchase a franchised business can make a lot of sense. In a typical franchise system the company that owns the business (the "franchisor") grants a right to a purchaser (the "franchisee") to operate the business using the franchisor's trademarks and operating system in an exclusive geographic territory for a fixed period of time. The result is that the franchisee can benefit from a "prepackaged" business with a proven operations system, valuable trademarks, exclusive territory and collaborative marketing that they could not have generated for themselves if they attempted to operate as an independent start up.

Prior to buying a franchised business, however, the would-be entrepreneur should give careful consideration to many things: their proposed investment, their individual skills, their personal goals and the legal aspects of franchised businesses. In the United States franchises are governed by both federal and state law. Under the franchise regulations administered by the Federal Trade Commission a business arrangement is a regulated "franchise" if goods and services are distributed under a franchisor's trademark, the franchisor exercises significant control over or provides substantial assistance to the franchisee, and the franchisee is obligated to pay the franchisor at least \$500 by the end of the first six months operation of the business. The right to use the franchisor's trademarks (like McDonald's Golden Arches) and the maintenance of uniform operations through substantial contractual controls by the franchisor are the hallmarks of a franchise system.

If a business arrangement falls within the federal regulation of franchises, then the franchisor must provide certain relevant information about the business to the franchisee before the franchisee purchases its business. This federally required information is contained in a "franchise disclosure document" or "FDD." Under the federal law the FDD must contain information on 23 specific topics relevant to the franchisor's business and the franchisee must have the FDD for 14 calendar days before buying the franchised business. FDDs can be voluminous and intimidating documents, but contain helpful information such as the prior business experience of the franchisor's executives, lawsuits against the franchisor, the fees a franchisee can expect to pay the franchisor, the contact information of current and past franchisees in the system and copies of the contracts involved in the franchise relationship, including the franchisor's form Franchise Agreement.

Entrepreneurs should pay close attention to the information revealed in the FDD and the terms of the Franchise Agreement because once they purchase the franchise they will have to live with these documents. Recently a North Carolina franchisee sued its franchisor claiming that the franchisee was defrauded into purchasing a bakery and coffee business by verbal representations by the franchisor's agent that the construction upfitting costs for the franchise location would be much less than they actually turned out to be. The North Carolina Business Court ruled against the franchisee on the grounds that the FDD and the Franchise Agreement specifically provided that their written terms superseded any verbal representations

made to the franchisee in the purchase of the franchise, and that the written terms expressly disclaimed any warranties as to the costs of opening and operating the restaurant. In short the franchisee was stuck with the terms of the FDD and Franchise Agreement as written.

So what should a potential buyer look for in an FDD and Franchise Agreement? First, with regard to the FDD, one of the most important things the buyer should do is contact personally those existing and former franchisees disclosed in the FDD to talk with them about their experiences as franchisees within the system. Existing and former franchisees will often be very frank about any issues or problems they have experienced with the franchisor. If a buyer talks to a number of them and hears a consistent complaint echoing through their answers, then he knows he has hit upon something he should take into consideration before purchasing.

Second, with regard to the Franchise Agreement, the buyer should determine those provisions of the Franchise Agreement that may be subject to negotiation with the franchisor. Not surprisingly Franchise Agreements usually are drafted by franchisors in very one sided terms favoring the franchisors. As a general principle a franchisor wants to maintain uniformity among the franchisees within its system, and thus those contract provisions that bear directly upon uniformity within the system typically are less negotiable than those that do not. Also, generally speaking, the older and more established a franchise system is the less flexibility it will demonstrate in the negotiation of its Franchise Agreement. A younger or less established system that is eager to recruit quality franchisees however frequently will be more open to varying its Franchise Agreement terms in order to attract the buyer. Buyers should consult with experienced counsel to understand the information disclosed in the FDD and to negotiate favorable terms in the Franchise Agreement.

Finally, in any decision to purchase a franchised business the compatibility of the buyer with the business itself is crucial. Different people with different skills and personalities are suitable for different types of businesses. One size does not fit all. A potential buyer should conduct a candid assessment of his own abilities and interests before purchasing a franchise to determine whether he and the opportunity are right for each other and the extent to which he will need to hire in his new business individuals with necessary skills that he himself does not possess. A good franchise broker typically will assist a prospective purchaser with that process of self discovery and matching personality with business opportunity.

Starting a business is a huge challenge, but the potential rewards are likewise great. Purchasing a franchised business on favorable terms can give the entrepreneur an advantage over "going it alone." With the assistance of experienced counsel the franchisee can achieve his dream of business ownership and financial success for himself and his family.

*This Article provides only a general overview of complex legal issues. It is not intended to be legal advice or a substitute for obtaining legal advice from an attorney familiar with the facts of your situation.*

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