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Franchising and the law: “Dos and Don’ts”

This article contains a very brief examination of the law applicable to franchising. It also sets out a brief list of “dos and don’ts” for both franchisors and franchisees.

Franchising involves the grant by one party (the “franchisor”) of the right to another party (the “franchisee”) to sell good or services under the intellectual property rights of the franchisor. The franchise agreement will govern this relationship.

There is no single statute or code which governs the law as it relates to franchising. The law of franchising is for the most part governed by the ordinary principles of contract law, the laws relating to intellectual property, and also in many instances competition law. There will of course be some overlap with other areas of law, including for example employment law, property, sale of goods and supply of services legislation and taxation.

The absence of any single governing code means that there is considerable scope for creativity in negotiating or renegotiating franchise agreements. The scope for this creativity can sometimes be overlooked, leading to a rigid adherence to precedent arrangements that may not always fit the desired relationship. On the other hand, the lack of any one source of legislation can also give rise to a misplaced belief that no laws apply to this area. It is important that both the franchisor and the franchisee (and obviously also their advisors!) have a thorough understanding of contract law and of franchise arrangements generally before entering into a binding relationship.

Set out below are some basic “dos and don’ts” for both the franchisor and the franchisee. Obviously, we would strongly advise that specific legal advice be taken in the circumstances described below – these are intended merely as a guide based on our experience, but no two franchise relationships are the same.

1. **Franchisor & Franchisee: DO take specific legal advice on negotiating the franchise agreement.** The franchisee will be acquiring significant rights from the franchisor. The franchisor will, understandably, want to maintain a degree of control over the franchise. As stated above, there is no “franchising law” *per se* and so the relationship between franchisee and franchisor will be governed almost exclusively by the franchise agreement. Thus, the importance of this document cannot be overstated.
2. **Franchisor: DO try to maintain a balance in the franchise agreement.** In practice, it is the franchisor’s solicitor that prepares the franchise agreement. However, and as the agreement will almost always form a template for multiple franchise relationships, it is critical that a reasonable balance is achieved. A franchisor should avoid varying the terms of its franchise agreements because it may cause upset to franchisees if some have better terms than others. Also, disparities in contract terms may result in a greater administrative burden on the franchisor.
3. **Franchisee: DO conduct your own thorough due diligence process before committing.** For example, do you have the experience and skills necessary to make the business a success? Just as importantly, does the franchisor have the necessary experience and skills to help you make the franchise a success? Do not be afraid to ask searching questions. And make sure you too take proper legal and financial advice so that you fully understand the extent of your obligations before committing to them.

4. **Franchisor & Franchisee: DO consider carefully who should be a party to the Franchise Agreement.** Will the franchisee be a company with limited liability? If so, will the individual behind that company be required to give a personal guarantee? The franchisor may insist on this. The franchisor may also insist on certain restrictive covenants, for example non-compete provisions, applying to both the franchisee and the individual guarantor.
5. **Franchisor & Franchisee: DO consider the commercial terms very carefully.** These will obviously include such matters as the initial fee, ongoing management fee obligations, advertising levies etc. The franchisor must ensure it has appropriate rights of access to verify the amounts due to it. The franchisor should also consider whether an initial fee is necessary. A hefty initial fee may discourage potential franchisees, who might consider the franchisor's business model to be based more on making a quick buck than developing a long-term and mutually beneficial relationship.
6. **Franchisor & Franchisee: DO consider the issue of exclusivity very carefully.** Granting an exclusive territory to a franchisee may cause a major headache for the franchisor if the franchisee's territory is not properly targeted. Believe me, this happens in practice! For the franchisee, the main advantage of exclusivity is that it will be protected from competition from both the franchisor and other franchisees. If granting exclusivity, the franchisor must be very careful that appropriate remedies are in place to protect against underperformance. Both parties should also consider compliance with competition law where exclusive rights are granted.
7. **Franchisor & Franchisee: DO consider how long the initial term should be.** The duration of the agreement should be long enough to allow individual franchisees to amortise their initial investments specific to the franchise. Consider also the terms for renewal which should also be dealt with in the franchise agreement.
8. **Franchisor: DON'T think that you can simply abandon the relationship if it is not working out for you.** The franchisor's basic obligation is to put the franchisee in a position to operate the franchised business. The High Court in Ireland has determined that the relationship between franchisor and franchisee is much closer than most other contractual relationships, and falls somewhere between an employer/employee relationship and that of independent contractors. Be aware of the extent of both your initial and ongoing obligations.
9. **Franchisor & Franchisee: DO consider at the outset how disputes will be resolved.** This should be specifically addressed in the franchise agreement.
10. **Franchisor & Franchisee: DON'T let a dispute escalate to a point where the relationship is irretrievably damaged.** Think outside the box. It might be that co-operation on some remedy, even outside of what is contained in the franchise agreement, would be in everyone's best interests. For example, a franchisee might be willing to forfeit its exclusivity in return for some other concession. We have found in practice that there is often scope for the parties to save the business if they are willing to be creative and to negotiate terms of a compromise arrangement rather than drive the business into the ground.

If you wish to discuss any of the above or if you have any other comments or queries, please contact:

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