Incorporating Strategic Thinking Into Your Franchise Agreement

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What strategic thinking went into your original agreement?
Territory Definition

• Key issues to consider when defining territories
  – Understanding the demographic and trade area needs of your business model
  – Are minimum performance requirements relevant to the business? How should they be determined?
  – What rights should the franchisee have to market and provide services outside their territory?
  – Don’t overcomplicate your territory structure
Territory Carveouts

• Similar businesses under different names.

• A corollary to the first one involves the possible acquisition of a competitor, or the ultimate sale to a competitor.

• Alternative methods of distribution.
Setting Initial and Renewal Terms

• In most cases, a longer term benefits the franchisee, and a shorter term benefits the franchisor
• Term needs to consider the expected ROI for franchisees in the system
• What term length is fair to both parties?
• Appropriate length for renewal terms
• Awarding perpetual renewal rights
• Tying renewals to physical upgrades of the franchisee’s location
Providing Flexibility to Address Future Changes

You will operate your Anytime Fitness Center through strict adherence to any mandatory standards, specifications and policies of the System as they exist from time to time, in order to ensure compliance with the quality standards of the System.
Providing Flexibility to Address Future Changes

We will loan you one copy of the manual in which we describe the operational policies, standards, requirements and practices of the System (the “Manual”). The Manual may be loaned to you by providing you access to an electronic version of the Manual. You will comply with all provisions of the Manual. We have the right to revise the Manual at any time or add additional manuals. You will not make copies of any portion of the Manual without our prior written consent. You will operate your business in conformance with all mandatory provisions of these manuals. You acknowledge that these manuals are designed to protect our standards and systems and our Marks, and not to control the day-to-day operation of your business.
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Providing Flexibility to Address Future Changes

- Insurance - do you list amounts in your agreement or reference a manual.
  - If you reference the manual, are the amounts actually in the manual?
  - If it is in your agreement, be certain you allow the franchisor to increase the amounts from time to time.
Providing Flexibility to Address Future Changes

• Trademark
  – We have the right to change or modify any of the Marks, including the principal mark under which your business is identified, from time to time, as we deem appropriate in our sole discretion. If we modify or discontinue the use of any Mark, you will immediately cease using the Mark, and will, as soon as reasonably possible, commence using the new trademarks, tradenames, service marks, logos, designs and commercial symbols we designate in connection with all advertising, marketing and promotion of your business. You will be responsible for all costs you incur in making these changes, including the cost of new signage.
Ensure one person is assigned the responsibility of ensuring your documents are consistent.
Fees
Recommendations for Defining Your System Marketing Requirements

• A new franchisor is unlikely to know what level of contribution will be appropriate as the system expands over time
  – Consider building flexibility into your marketing fund fee structure
  – Begin marketing fund contributions from the start
• It’s fine to under-promise on reporting back to franchisees, but over-deliver in terms of what information you actually share. Be as transparent as possible with your marketing fund
Franchisee Accounting and Reporting

Sample Language From a National Franchisor’s FDD

“Franchisee shall maintain true and accurate statements of its financial activity, and shall submit to Franchisor a profit and loss statement within 15 days of the end of each quarter.

In addition to the quarterly statements filed pursuant to this Agreement, Franchisee shall, within ninety days following the end of its fiscal year, provide Franchisor with a report of all sales during the year. Franchisee shall prepare its profit and loss statements in a format consistent with Generally Accepted Accounting Principals.”
Franchisee Accounting and Reporting

Recommendations For Your Reporting Requirements:

• If you’re a new franchisor, set-up your accounting system using thirteen four-week periods each year.

• Maintain flexibility to require franchisees to submit their profit and loss statements at whatever intervals make sense for your system over time.

• If you’re a new franchisor, develop and mandate a standard chart of accounts and profit and loss statement format that all franchisees must use.

• Require all franchisees to generate monthly profit and loss statements for their business.

• Ensure year-end statements are submitted on a calendar-year basis.
Franchisee Reinvestment

Sample Language From a National Franchisor’s FDD

“Franchisee shall repair, refurbish, modernize, renovate and upgrade its location periodically to maintain it in a clean, attractive and orderly condition, to provide efficient, high-quality service to the public, and to conform to ongoing standards and specifications applicable generally to restaurants in the System, all in accordance with the Operations Manual as periodically revised by Franchisor. Franchisor shall not require substantial updates more than once every five years during the term of Franchisee’s contract”

What defines a “substantial update?”
Franchisee Reinvestment

It is recommended that reinvestment standards separately address three critical areas impacting most franchised businesses:

1. Day-to-day/routine maintenance of the franchisee’s facility
2. New or upgraded equipment and technology
3. Reimagining the franchisee’s trade dress

If the franchisor operates its own locations, it must also lead by example on the issue of facility reinvestment.
Contemplating Future Supplier Arrangements

• Be certain the documents allow for the specification of additional required items (not just inventory). And additional required suppliers.

• Include in the FDD broad language allowing future supplier arrangements, including rebates
Providing Rights Short of Termination or Litigation

If we reasonably believe that you are not meeting any of our standards, specifications or policies, or if your Anytime Fitness Center fails any inspection we may make, or fails certain areas of our inspection, we may assign one or more persons to your Anytime Fitness Center to provide additional training and assistance, and you will be responsible for reimbursing our costs of doing so. In addition, should any of these situations occur, we may hire independent third-party “mystery shopper” services to visit your Anytime Fitness Center, and you will be responsible for reimbursement of any fees those services charge us.
Providing Rights Short of Termination or Litigation

Pre-termination Options. Prior to the termination of this Agreement, if you fail to pay any amounts owed to us or our affiliates or fail to comply with any term of this Agreement, then in addition to our right to terminate this Agreement or to bring a claim for damages, we have the option:

1. to remove the listing of your Anytime Fitness Center from all advertising published or approved by us;
2. to cease listing your Anytime Fitness Center on our Anytime Fitness® Home Page, and to discontinue any links from that site to any site for your Anytime Fitness Center;
3. to prohibit you from attending any meetings or programs held or sponsored by us;
4. to terminate your access to any computer system or software we or our affiliates maintain or license to you; and/or
5. to suspend all services we or our affiliates provide to you under this Agreement or otherwise.
Dispute Resolution Provisions

• Required mediation before any legal proceedings

• Arbitration v. Litigation
  – Give yourself the right to get injunctive relief on “system” issues
  – Do you require venue where the franchisor is today, or where the franchisor may be in the future, or neither?
Drafting an Enforceable Noncompete Provision

• Separate the “in-term” and “post-term” covenants.
• Narrowly define what is prohibited.
• Limit noncompetition to areas that would really compete with an outlet.
• Have the franchisee acknowledge the reasonableness of the clause, and that damages would not be sufficient.
• Extend the post-term noncompete to run from the time that all competition ceases.
• Be certain you have a “survival” clause.