

## SHOULD I PURCHASE A FRANCHISE?

**D**o you wish to “jump start” your new business by acquiring a franchise? While this will give you quick access to a recognized name, business organization, training and advice, there is a cost in franchise fees, royalties and legal restrictions on the operation and future sale of the business. If you are considering purchasing a franchise or an existing franchise business, there are several critical legal issues that you should consider before proceeding:

### What Does the Franchise Agreement Require?

The franchise agreement is a complex legal document that sets forth the legal relationship between the company that is permitting you to use its franchise name, ideas, concepts, etc. (the “Franchisor”) and you (the “Franchisee”). While the Franchisor will always prepare a franchise agreement which favors its interests, the agreement may be reasonable to you or can be completely unfair. Although they will deny it, Franchisors will sometimes negotiate “deal breaking” points in the franchise agreement rather than lose the deal with you. A thorough and informed analysis of the franchise agreement before signing is essential to understanding the franchise and protecting your interests.

### Government Approval

All Franchisors must provide a disclosure statement to comply with United States law. Some states require the disclosure of additional information, but it is critical to remember that the government does not review or approve any franchise’s business plan. A Franchisee is not treated like a consumer in the eyes of the law, but as a fully informed business person. In acquiring a franchise, the rule is caveat emptor – let the buyer beware – so if you act carelessly and fail to ask the right questions, you might have to live with your mistakes. Proper qualified advisors are essential to making a wise decision.

### Fees and Royalties

You must carefully evaluate the business terms of the franchise agreement, especially the initial fee and recurring payments or royalties. Do they adequately reflect the value of the franchise and will you be able to generate enough revenue to cover them? You should carefully consider whether the Franchisor is interested and committed to a long term relationship with you, or merely in the business of generating initial fees for itself.

### Continuing Support

What will be the role of the Franchisor in your new business? Will you be “on your own” after you open for business with little or no support from the Franchisor, or will the Franchisor provide support to your business for the long term? You can talk to other franchisees to share their experiences with the Franchisor.

### Franchise Agreement Term

How long does the franchise agreement last? What are your rights to extensions and renewals? Your obligations under the agreement continue as long as the agreement is in effect. Even if your business fails, you will still have liability for performing your obligations under agreement. Conversely, if the franchise agreement terminates after 5 or 10 years without renewal rights, you could lose a successful business that you worked long and hard to establish.

## **Insurance**

Commonly overlooked and under-appreciated is adequate insurance coverage. Your insurance agent should review your obligations as a Franchisee to advise you as to adequate coverage.

## **Exclusive/Protected Area**

Will you have the exclusive right to the franchise “brand” within an adequate area? You must be certain that another franchise will not open for business so close to you that your business suffers.

## **Personal Liability**

The Franchisor will want you to be personally liable under the franchise agreement. Conversely, you will try to shift as much of the liability and obligation to your business entity. While Franchisors are unlikely to permit you to shift all of the liability to your business entity, you must understand how and to what extent you are personally liable.

## **Business Entity**

When you conduct business in New Jersey, you can choose from among corporations, limited liability companies, general or limited partnerships and sole proprietorships. The entity that you should choose depends largely upon the type of business you are in and other important factors.

## **Laws and Regulations**

What federal, state and local laws, rules and regulations govern the franchised business? A Franchisor active in many states may not know the legal requirements for a franchised business in your state and town. New Jersey has a Franchise Practices Act that may offer you important protections.

## **Post-Termination Restrictions**

The franchise agreement may have provisions that prevent you from owning the same or a similar business. If you are unhappy with the franchise, you may not be able to terminate it without giving up your business entirely. Continuing in business without the franchise may not be a legal or practical option.

## **Location and Lease**

The Franchisor may select a location for you based on demographic studies and business theories and usually will have a right to approve or disapprove a location you select, but will it really be right for the business? If it is not, it is your business that will suffer. The Franchisor may pressure you to accept a location or lease that does not work for you. The lease for the location should be renewable and transferable at the same time as the franchise agreement. Of course, the lease is itself a complex document like the franchise agreement and must be read carefully, negotiated, and signed only if it is wholly acceptable to you.

*This overview lists some of the initial critical considerations that must be made when considering purchasing a franchise. Please note that such overview is for discussion purposes only and that your personal situation will influence your decisions and that you should seek competent legal advice before proceeding further with such franchise agreement. At Wilentz, Goldman & Spitzer, P.A., our corporate attorneys can work with you to identify your goals, choose an entity and evaluate the franchise agreement and related documents. To give you predictable up front costs, we have a flat fee package of legal services which includes formation of a business entity and the review of a franchise agreement and real estate lease. Our goal is to see you make the right decision, succeed and to form a long-term relationship with you.*

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