Hamilton Pratt Article

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LEGAL ASPECTS TO CONSIDER BEFORE INVESTING IN A FRANCHISE

Investing in a franchise is an important step that should not be taken lightly because it is not cheap and it will require your long-term commitment. Therefore, as with any long-term commitment, there is a lot that you should consider before you sign on the dotted line including finances, your family's support, your ambition and drive and selecting the right business for you. This article, however, will focus on just the legal aspects.

The UK is one of the few countries that does not have franchise-specific laws or regulations which means that legal principles apply. You have to be particularly cautious when entering into a franchise, taking your time to investigate the franchise carefully because the franchise agreement will seek to protect the franchisor from any claims. Due diligence before you commit by signing the franchise agreement is therefore essential!

Your due diligence should comprise of finding out as much as you possibly can about the franchisor and its franchise system. How long has it been in operation and has it traded profitably - do not be afraid to ask the franchisor for a copy of its latest accounts. Is it a member of the BFA and if not, why not. You should obtain a list of all franchisees and talk to as many as you can and not just those that the franchisor wants you to talk to! What is the failure rate and how many franchisees have been terminated or ceased to trade in the last 12 months? What were the reasons for such failures or terminations? This is the minimum information you need.

It is essential that you obtain legal advice from an experienced franchise solicitor.

Any business plan or cash flow forecast which the franchisor provides to you should be based on the actual performance of the franchisor's franchisees and you should ask the franchisor to confirm that this is indeed the case. If any of the financial information which the franchisor provides to you is incorrect or if the figures have been exaggerated in order to encourage you to enter into the franchise then you may have a misrepresentation claim against the franchisor although the purpose of the financial due diligence is, of course, to provide you with sufficient information to enable you to make the right decision based on hard facts rather than seeking to put yourself in a position to bring a claim against a franchisor!

One of the most important aspects of any franchise system, which is often overlooked is the franchise agreement. It is essential that you obtain legal advice from an experienced franchise solicitor. It is a legally binding agreement which will usually last for at least 5 years and it is therefore of vital importance that you take your time to read it, understand it and to have it reviewed. You can obtain a list of affiliated lawyers from the BFA's website.

You will also have to comply with the operations manual which sets out the operational requirements of your franchise. The franchisor will have the right to amend and update the manual but you should still ask to see the operations manual before entering into the franchise agreement. Given the confidential nature of the document most franchisors do not let you have a copy of the manual unless and until the franchise agreement is signed but it is becoming increasingly common for prospective franchisees to be allowed to review the manual at the franchisor's premises and in the franchisor's presence prior to signing the franchise agreement.

Franchisors with mature networks will often have existing franchisees who are looking to sell their businesses and it may be worth investigating whether you should invest in a new territory or buy an existing developed business. The second option is often a more expensive one but it does come with an established database of customers and local recognition.

Adopt a cautious approach and never, under any circumstances, be rushed or pressured into entering into a franchise agreement

If you are taking on a franchise which requires you to have premises, you will need to be careful timing the entry into the lease and the franchise agreement. You would not want to be in a position where your franchise term has started and you are committed to paying fees to the franchisor but you are unable to start trading because you do not have the premises. At the same time you would not want to be tied into a lease over the premises and not have the right to operate the franchise. Ideally the lease and franchise agreement would be entered into at the same time.

Last but not least you should consider how you would structure your future business – will you be operating as a sole trader in your own name or will you set up a limited company? Increasingly franchisees operate through a limited company because the individual then has protection from personal liability, although the individual will always be personally liable to the franchisor. Franchisees usually need to obtain guidance from their accountants on which is the best structure for them.

You should always adopt a cautious approach and never, under any circumstances, be rushed or pressured into entering into a franchise agreement.

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