

Checklist of Basic Franchise Agreement Terms

Franchise agreements vary from franchise to franchise. It would be impossible to identify every term and issue that should be considered in every situation. However, this checklist should be a valuable tool if you're interested in buying a franchise.

The checklist should be used in conjunction with the franchise agreement—the document that will set out all the terms and conditions that will govern your ownership of the franchise—which will be drafted by the franchisor. You can use this checklist either before you see the franchise agreement, in order to get an idea of what should be in it, or after you have a copy of the agreement, in order to review its terms.

In any event, while you can use the checklist to understand and review a franchise agreement, you shouldn't sign it until you've discussed your options with your attorney.

Issues Pertaining to the Franchise Cost Terms

- What does the initial franchise fee purchase?
- Does it include an "opening" inventory of products and supplies?
- What are the payment terms: amount, time of payment, lump sum or installment, financing arrangements, etc.?
- Does the franchisor offer any financing, or offer help in finding financing?
- Are there any deferred balances? If so, who finances and at what interest?
- Is any part or all of the initial fee refundable?
- Does the contract clearly distinguish between "total cost" and "initial fee," "initial cash required," or "initial costs," etc.?
- Are there periodic royalties? If so, how much are they and how are they determined?
- How and when are sales and royalties reported, and how are royalties paid?
- If royalty payments are in whole or part payment for services by the franchisor, what services will be provided?
- Are accounting/bookkeeping services included or available?
- How are advertising and promotion costs divided?
- Is a specified amount of working capital required of the franchisee to cover operating costs until profits can be made?
- Must premises be purchased or rented, and are there further conditions on either of these (from franchisor, selected site, etc.)?
- How and by whom will the building be financed, if purchased?
- Does the franchisee have to make a down payment for construction and/or equipment?

Issues Pertaining to the Franchise Location Terms

- Does the franchise apply to a specific geographical area? If so, are the boundaries clearly defined?
- Who has the right to select the site?
- Will other franchisees be permitted to compete in the same area, now or later?
- Is the territory an exclusive one, and is it permanent or subject to reduction or modification under certain conditions?

- Does the franchisee have a first refusal option as to any additional franchises in the original territory if it is not exclusive?
- Does the franchisee have a contractual right to the franchisor's latest products or innovations? If so, at what cost?
- Will the franchisee have the right to use his own property and/or buildings? If not, will the franchisor sell or lease his property to the franchisee?
- Who is responsible for obtaining zoning variances, if required?

Issues Pertaining to the Buildings, Equipment and Supplies Terms

- Are plans and specifications of the building determined by the franchisor? If so, does this control extend to selection of contractor and supervision of construction?
- Are there any restrictions on remodeling or redecorating?
- Must equipment or supplies be purchased from the franchisor or approved supplier, or is the franchisee free to make his own purchases?
- When the franchisee must buy from the franchisor, are sales considered on consignment? Or will they be financed and, if so, under what terms?
- Does the agreement provide for continuing supply and payment of inventory (by whom, under what terms, etc.)?
- Does the franchise agreement bind the franchisee to a minimum purchase quota?
- What controls are spelled out concerning facility appearance, equipment, fixture and furnishings, and maintenance or replacement of the same? Is there any limitation on expenditures involved in any of these?
- Does the franchisor have a group insurance plan? If not, what coverage will be required, at what limits and costs? Does the franchisor require that it be named as an insured party in the franchisee liability coverage?

Issues Pertaining to the Operating Practices Terms

- Must the franchisee participate personally in conducting the business? If so, to what extent and under what specific conditions?
- What degree of control does the franchisor have over franchise operations, particularly in maintaining franchise identity and product quality?
- What continuing management aid, training and assistance will be provided by the franchisor, and are these covered by the service or royalty fee?
- Will advertising be local or national and what will be the cost-sharing arrangement, if any, in either case?
- If local advertising is left to the franchisee, does the franchisor exercise any control over such campaigns or share any costs?
- Does the franchisor provide various promotional materials point-of-purchase, mail programs, etc. and at what cost?
- What are bookkeeping, accounting and reporting requirements, and who pays for what?
- Are sales or service quotas established? If so, what are the penalties for not meeting them?
- Are operating hours and days set forth in the franchise contract?
- Are there any limits as to what is or can be sold?
- Does the franchisor arrange for mass purchasing and is it mandatory for the franchisee to be a participant buyer?
- Who establishes hiring procedures initially and through the franchise term?

Issues Pertaining to Termination and Renewal Terms

- Does the franchisor have absolute privilege of terminating the franchise agreement if certain conditions have not been met, either during the term or at the end?
- Does the franchise agreement spell out the terms under which the franchisor may repurchase the business?
- Does the franchisor have an option or duty to buy any or all of the franchisee's equipment, furnishings, inventory, or other assets in the event the franchise is terminated for good cause, by either party?
- If the preceding situation occurs, how are purchase terms determined?
- Is there provision for independent appraisal? Is any weight given to good will or franchisee equity in the business?
- Does the original agreement include a clause that the repurchase price paid by the franchisor should not exceed the original franchise fee? If so, this eliminates any compensation for good will or equity.
- Under what conditions (illness, etc.) can the franchisee terminate the franchise? In such cases, do termination obligations differ?
- Is the franchisee restricted from engaging in a similar business after termination? If so, for how many years?
- If there is a lease, does it coincide with the franchise term?
- Does the contract provide sufficient time for amortization of capital payments?
- Has the franchisor, as required, provided for return of trademarks, trade names, and other identification symbols and for the removal of all signs bearing the franchisor's name and trademarks?

Other Points To Consider

- Can the franchisee sell the franchised business and assign the franchise agreement to the buyer?
- Is the franchise assignable to heirs, or may it be sold by the franchisee's estate on death or disability?
- Does the lease permit assignment to any permitted assignee of the franchisee?
- How long has the franchisor conducted business in its industry, and how long has it granted franchises?
- How many franchises and company-owned outlets are claimed, and can they be verified?
- If there is a trade name of a well-known person involved in the franchise, is he active, does he have any financial interest, does he receive compensation for work or solely for use of his name, etc.?
- Are all trademarks, trade names, or other marks fully identifiable and distinct, and are they clear of any possible interference or cancellation owing to any pending litigation?
- What is the duration of any patent or copyright material to the franchise? If time is limited, does the franchisor intend to renew, and is this spelled out in the franchise agreement?
- Has the franchisor provided the franchisee with an offering document package meeting FTC rule requirements or the UFOC format?
- Has the franchisor met all state law requirements (registration, escrow or bonding requirements, etc.), if applicable?
- Are there state laws governing franchisor/franchisee relationships, including contract provisions, financing arrangements and terminations? If so, does the contract meet all requirements?