

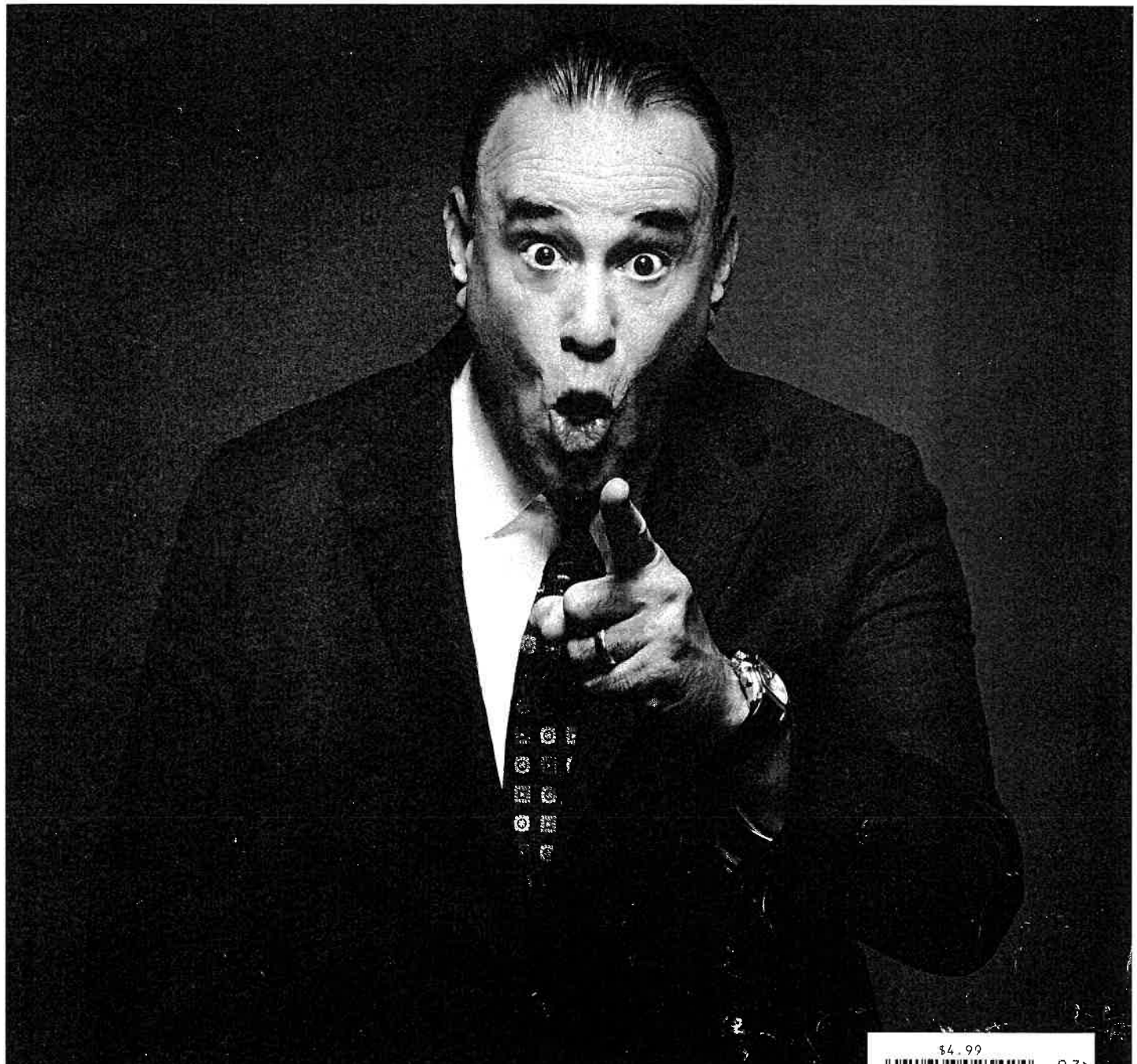
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How Franchisees Protect Themselves

Franchisees and franchisors need each other to survive, but that doesn't mean every relationship is perfect. A longtime franchisee lawyer explains how franchisees can best protect their business interests.

by **LISSA HARRIS**

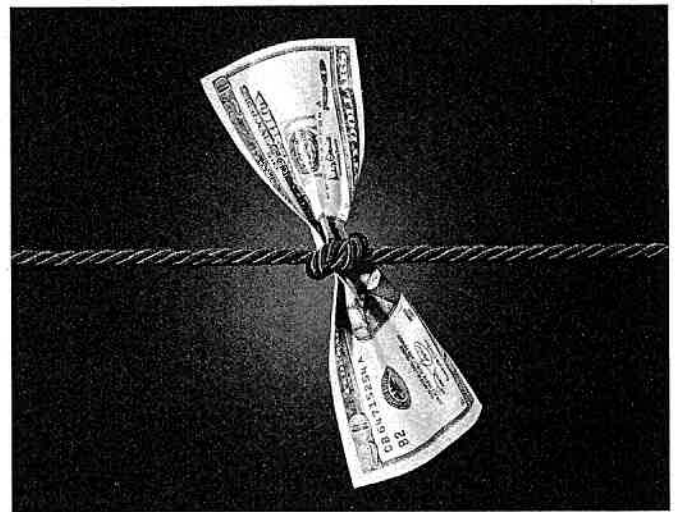
Buying a franchise from a large corporate parent *should* be a friendly transaction—everybody at the table wants your business to succeed. But when plunking down your life savings and all the money you can borrow on a franchise business, you still need to look out for your interests, says

J. Michael Dady, founding partner of Dady & Gardner, a firm specializing in franchise law.

“There’s an inherent conflict between franchisors and franchisees,” Dady says. “Franchisors care about top-line revenues; franchisees care about bottom-line cash flows.” In other words, franchisors’ royalties are based on a franchise’s gross revenue, not profit. So franchisors are always looking for ways to pump up top-line revenue—sometimes, franchisees claim, at the expense of individual franchisees’ cash flow. (Subway, for example, recently reintroduced the \$5 Footlong promotion; Dady now represents franchisees who say the low-cost meal cuts too hard into their margins. In cases like these, franchisors often respond that the lower costs lead to higher volume, and that both sides will make more money overall.)

After more than 40 years of experience representing franchisees, Dady has seen his fair share of relationships go south. His advice to would-be franchisees: Get good financial and legal advice up front, do your homework before you sign anything, and ask the tough questions before getting into an agreement. “You should have a better reason for buying a franchise than the fact that you like a company’s sandwiches,” he says.

Here are five big things he says every franchisee should consider before signing a contract.



1/ Negotiate the long term.

Many franchisees assume they can operate as long as they’re meeting performance criteria, but that might not be the case. “A lot of agreements have end dates that have to be negotiated at the end of 10 or 20 years,” he says. “If you want to continue, you have to do it on less favorable terms.”

2/ Clear the way for a sale.

At some point, a franchisee may want to sell. Some brands try to secure a right of first refusal—that is, the brand itself has the first shot at buying back the unit. Dady says he fights for clients to get contracts free of this condition, which can diminish the sale value.

3/ Have an exit plan.

If a franchisee is losing money five years into a 20-year contract, they may want to sell. But many contracts prevent it, and suing for the right to close can leave franchisees on the hook for years of future royalties. Says Dady: Fight for early-out rights.

4/ Protect your territory.

Competition doesn’t come just from other companies; sometimes two franchisees from the same brand may end up eating each other’s lunch. Dady says potential franchisees should always ask, “Do we have appropriate territorial protection?” That question extends beyond physical stores, too. In 2000, for example, Dady’s firm successfully argued a case against Drug Emporium on behalf of franchisees who claimed the parent company was encroaching on their territory with online sales.

5/ Find your support system.

“Certain states have good franchise relationship statutes, and franchisees have more rights in those states,” Dady says. But the legal landscape is ever-changing, as are standard franchise contracts. That’s why, in recent years, professional associations representing dealers and franchisees have multiplied. “They have common interests, so they can look out for each other,” he says. Dady says entrepreneurs should get in touch with one before they become franchisees.