"The Good, the Bad, and the Ugly"
Franchise Agreement and FDD Provisions
One Franchisee Lawyer's Perspective

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1. **The Duration of the Relationship**
    - The Good: Consecutive, unlimited, renewal terms, with renewal agreements that do not materially differ over time.
    - The Bad: Limited renewal rights, expressly allowing material, adverse changes to renewal agreements.
    - The Ugly: No renewal rights, with franchisor claiming the right to acquire the franchisee's business at the end of the term for the fair market value of the hard assets.

2. **Franchisor Termination Rights**
    - The Good: For good cause only, and only after specific notice of perceived deficiencies and a reasonable opportunity to cure.
    - The Bad: For good cause only, but with no opportunity to cure.
    - The Ugly: If franchisee is deemed to be in default of any franchise agreement, all of the franchisee's franchise agreements may be terminated.

3. **Franchisee Early Out Rights**
    - The Good: Franchisee may terminate at any time, for any reason, upon 30 days' notice.
    - The Bad: Franchisee may terminate the franchise if it is not operating at a profit for some reasonable period of time – e.g., six consecutive months.
    - The Ugly: Franchisee may not terminate prior to the end of the specified term, and, if the franchisee does, the franchisor claims a right to liquidated damages or lost future royalties and ad fees over the remaining term.

4. **Protection from Same or SimilarBrand Competition**
    - The Good: Franchisee receives an exclusive territory in which neither the franchisor nor any franchisee of the franchisor will operate the same or a similar concept.
    - The Bad: Franchisee receives some limited protection against same brand competition, with the franchisor reserving broad rights to compete with similar brands and/or through alternative channels.
    - The Ugly: The franchisor states that no protection against same or similar brand competition exists and expressly claims the right to engage in such competition.

5. **Franchisor's Right to Unilaterally Change the Terms of the Franchise Agreement**
    - The Good: The franchise agreement contains no express right to unilaterally change it, and does not incorporate by reference any document – e.g., the operations manual – which may be unilaterally changed.
    - The Bad: The franchise agreement contains limited express rights to unilaterally change it – e.g., to make necessary technological changes – but with express limitations – e.g., fees may not be unilaterally increased.
    - The Ugly: The franchise agreement contains express unlimited rights to unilaterally change it and any documents incorporated by reference.

6. **Limits to the Franchisor's Exercise of Discretion**
    - The Good: The franchisor and the franchisee expressly agree to deal with each other in an honest, good faith, non-discriminatory, commercially reasonable manner.
    - The Bad: The franchise agreement is silent as to whether the parties will act reasonably, or otherwise, in their dealings with one another.
    - The Ugly: The franchisor claims the express right to exercise its business judgment in any way that, in its "business judgment," or in its "sole discretion," makes sense to it.

7. **Limitations on the Franchisee's Right to Transfer the Franchise**
    - The Good: The franchisee has the right to transfer ownership in the franchise, subject only to the franchisor's reasonable requirements as to the financial and operational abilities of the transferee.
    - The Bad: The franchisor has a right of first refusal on all transfers of all or any portion of the ownership of the franchise, and claims the express right to assign this right of first refusal, which must be freely assigned; and the transferee must sign the then current form of franchise agreement, which may have a term limited to the term remaining in the transferor's franchise agreement.
    - The Ugly: The franchise agreement has no transfer rights, and expressly states that the franchise agreement ends upon the death or disability of the principal owner.

8. **Dispute Resolution**
    - The Good: The franchisee has the right to litigate, or to arbitrate in front of a single arbitrator, in the state in which the franchise is located, pursuant to the laws in effect in that state, without any waiver of its right to a jury, with no limitations on the types of recoverable damages, and without any contractual shortening of the applicable statues of limitation.
    - The Bad: All disputes between the parties must be litigated, or arbitrated before a panel of three arbitrators, in the franchisor's home state, pursuant to the laws of the state in which the franchisor's home office is located.

- The Ugly: All disputes must be litigated, or arbitrated before a panel of three arbitrators, in the state in which the franchisor's home office is then located, with a jury waiver, with limitations on the types of recoverable damages, with a contractual shortening of otherwise applicable statutes of limitation, and with the franchisor claiming a one way right to recover attorneys' fees and costs in any dispute that arises.

9. <u>Item 19 in the Franchise Disclosure Document</u>

- The Good: Robust, comprehensive, accurate and helpful explicit financial performance representations.
- The Bad: None.
- The Ugly: Incomplete and/or misleading "cherry-picked" financial performance representations.

10. <u>Item 8 in the Franchise Disclosure Document</u>

- The Good: Franchisor expressly agrees to use its best efforts to negotiate with vendors for the benefit of franchisees, agrees to not take for itself any payments from any vendor, and agrees to remit to its franchisees, on a pro rata basis, all available vendor payments.
- The Bad: Franchisor does not negotiate for the benefit of its franchisees, and takes payments from vendors based on franchisee purchases, but commits to deposit all such vendor payments into the national advertising fund, but with broad discretion as to how those payments are spent.
- The Ugly: Franchisor does not negotiate for the benefit of its franchisees, and takes payments from vendors based on franchisees' purchases of required goods and services, but claims the right to use those payments for any purpose.