

Understanding your rights in selling your franchise

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Question: I am considering buying a franchise from a large well-known franchisor and notice that the franchisor has a right of first refusal should I try to sell my franchise before my term is up. Is this a standard clause in franchise agreements and will it impact how much I can get for my business should I decide to sell it? Should I avoid buying this franchise?

If you are considering the purchase of a franchise, you are likely to find that most franchisors have given themselves the right to purchase your franchise if you offer it to someone else. Rights of first refusal are common today in franchising.

Franchisors insert them into franchise agreements to provide some controls over who can join the franchise system. They also put them in so that they have the ability to acquire additional company owned locations that they may wish to operate or, they may think that your selling price is a bargain and they want to purchase your business so that they can sell it to another franchisee at a profit. These are all valid reasons for a franchisor to insist on a right of first refusal and in most situations; it is an important term of the franchise agreement for the franchisor. Most franchisors that have rights of first refusal in their franchise agreements will not negotiate with new franchisees about removing or altering this right.

For most franchisees, the right of first refusal means that when you receive a written offer from someone to buy your business, in addition to being able to approve or disapprove the buyer, the franchisor has the right to match their written offer. This means that the franchisor has the right to pay you the exact same amount as you were offered and make those payments under the exact same terms and conditions. The language of the agreement however may not be that simple though. As with everything else concerning the purchase of a franchise, it is important that you have an experienced franchise attorney assisting you in reviewing the franchise documents.

There are times that a buyer will not offer you a cash price for your business. For example, instead of setting a cash price, buyer's offer includes some property or includes another non-cash asset as part of the purchase price. In that situation, since the franchisor can't match the offer exactly, the franchise agreement may give them the right to appoint an appraiser who will value the business independently. Sometimes, but not always, you may have the right to appoint your own appraiser and sometimes those two appraisers may have the right to appoint a third independent appraiser. The reason for appointing an appraiser is to give a fair valuation of the purchase price when assets, other than cash, are offered or in situations where the purchase price or terms cannot easily be determined.

If it appears that the process of appointing an appraiser and waiting for their valuation will take some time you are right. It also can be expensive and you may have to pay the appraisers fees. The franchise agreement will specify the process and who pays the costs.

There are other potential negative impacts of the franchisor's right of first refusal. For example, if your potential buyer is sophisticated, they may not even consider your business because of the franchisor's right to match their offer.

Conducting a due diligence to determine a purchase price, when done correctly, can take time and cost money. Once the buyer has determined what your business is worth to them, there usually are some negotiations regarding their ultimate offering price. Factors that can impact their offer include the length of time you have left on your franchise agreement and the costs of bringing the location into compliance with the physical and other requirements of the franchise system. Sometimes, the new franchisee will be required to sign the then current franchise agreement offered by the franchisor. That agreement may contain terms different than you currently have in your agreement; including an increase in the fees you are paying the franchisor. These factors will usually have an impact on what the final offering price is and may result in an offer that is lower than you expected.

In the vast majority of purchase transactions, the franchisor's right of first refusal will have no impact on your ability to sell your franchise. You will simply inform the franchisor that you have received an offer to sell your franchise and while they may have 30 days or longer to make a decision on whether to match the offer, most franchisors, once they have evaluated your buyer as a potential franchisee, will make their decision about their desire to match the buyers offer very quickly. However, should the franchisor have made a determination to buy back franchises on a routine basis, your ability to find buyers willing to invest in the due diligence process may become limited because it will tend to stop sophisticated buyers from even considering your business.

While we always recommend to potential franchisees that they contact existing franchisees to discuss the franchise system, when it comes to a franchisor exercising its rights of first refusal, this advice may have limited benefit. Even if the franchisor has historically not operated company owned locations or acquired franchises when they came up for sale, the franchisor's strategy may change by the time you decide to sell your business.

Speak to your attorney or your other advisor about what rights the franchisor has retained in this area. If you think the franchisor's rights in the agreement are a block on your purchasing the franchise talk to them about it and with your attorney, see if they are willing to negotiate a change in your agreement.

In most cases the franchisor's right of first refusal will have no impact on you, but it is a significant right found in most franchise agreements and you should understand your rights before you sign on the dotted line.