

FRANLAW ⁷

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FRANCHISE INFO PACKAGE

WHY BUY A FRANCHISE?

- To increase your success, franchising clones successful businesses.
- Over 30% of all retail sales are made by franchises.
- Finding a good business to buy takes too long.
- Starting a business from scratch is too risky.

WHAT IS MOST IMPORTANT FOR A FRANCHISE BUYER TO KNOW?

- 90% of franchisors negotiate changes to the terms of franchise agreements.
- Use a franchise attorney who knows not only what to ask for but how to ask for it.
- Beware clauses trying to make you liable for future royalties after you are gone.
- Call a lot of franchisees to get the answers you really want to know.
- You will probably need to call 60 in order to have 20 who talk in depth with you.
- Avoid temptation of seeing only what you want to see.
- In order to have leverage for successful negotiations, you must play hard to get.
- Be sure to incorporate or form limited liability company.
- Negotiate everything in your lease.

WHAT ARE THE TOP LEGAL ISSUES TO KNOW WHEN STARTING IN BUSINESS?

- Sources of capital.
- Incorporation.
- Tax.
- Books and records.
- Shareholders Agreement.
- Trademark registration.
- Real Estate Lease.
- Franchise Agreement.
- Agreement for the Sale and Purchase of a Business.
- Commercial Contracts and Equipment Leases.
- Employee Issues.

READ THE ATTACHED ARTICLES TO LEARN MORE.

- How to Buy a Franchise.
- How to Start Your Own Business.

PRO'S AND CON'S OF FRANCHISING

PRO'S

- * A business format that has been shown to work.
Increases the likelihood of success for starting in business.
- * Customers know the name of the business.
Trademarks. Marketing.
Increased revenues.
- * Training and guidance.
Initial and ongoing.
- * Mentor/Leader.
- * Customers know the uniform and consistent quality among stores.
- * Site Selection and lease negotiation assistance.
- * Group discounts - by bulk purchasing for all franchised stores.
- * Co-op Advertising.

CON'S

- * Increased costs -- both initial and ongoing.
- * Training, guidance and rules can become restrictive or confusing.
- * Not all franchise systems are alike or as good.
- * If some franchisees do not maintain quality, it harms the reputation of your store.
- * Much more information and professional advice are needed in addition to that provided in the franchise disclosure document.
- * Restrictive contracts which need to be negotiated and amended.

QUESTIONS TO ASK WHEN BUYING A FRANCHISE

1. Has owning a franchise been good for you?
2. Were you trained properly for running the business?
3. What does the franchisor do well for you?
4. What do you think of the franchisor's marketing and advertising programs?
5. What is the biggest advantage of your business?
6. What is the greatest weakness of the business?
7. Why might one fail in this business?
8. How long did it take before you started making a profit? Are you making the money you expected? How much money do you make?
9. What did it cost you to build and start the franchise?
10. Did you finance the cost of the business? How easy was that?
11. How many hours a week do you work on the franchise?
12. What is the reputation of the franchisor in the industry?
13. Is the business different from what you originally expected?
14. Does the management have the expertise and experience to teach you how to operate the business?
15. Are you satisfied with what the franchisor is doing?
16. If you had to do it all over again, would you select the same business and the same franchisor?
17. Are there restrictions regarding suppliers from whom you can buy goods and services? Has that been a problem? Are costs okay?
18. How thorough a job did the franchisor do with the site selection and lease negotiation process? And with the whole pre-opening process?
19. How did you obtain sales and profit information to help you with your initial plans?
20. Does the franchisor seem financially healthy?
21. Is there any turmoil in the franchise system?
22. Are there any new products or developments coming out?

TYPES OF FRANCHISES

Business Format Franchise

Product Franchise

Single Unit

Multiple Units

Area Development

Subfranchising

ADDITIONAL WAYS TO BEGIN FRANCHISING

PURCHASE AN EXISTING FRANCHISE STORE.

Reasons for sale:

- Profitability +/-
- Retirement
- Health
- Death
- Burn out
- Moving
- Dispute among owners

Pro's:

- Price
- Operating history
- Financial records
- Customer base
- Seller financing

Con's:

- Price
- Overcoming poor reputation
- Remodeling costs
- Poor location
- Skeletons

CONVERT AN EXISTING STORE INTO A FRANCHISE.

Take advantage of the strengths of the franchise system in the marketplace. For example, good name, advertising programs, and supplier discounts.

Pro's:

- Lower upfront costs involved in converting
- Use trademark, co-op advertising. Reputation
- Established business operating procedures

Con's:

- Remodeling costs
- Restrictions by the franchisor over the operation of the business
- Initial and ongoing fees to franchisor

WHAT IS IN A FRANCHISE DISCLOSURE DOCUMENT

1. Background of the Franchisor Company. Items 1, 2, 3 and 4.
2. Fees and costs. Items 5, 6, and 7.
 - Franchise fee.
 - Royalty.
 - Franchisee advertising fund.
 - Local advertising.
 - Additional advertising.
 - Opening advertising.
 - Estimated initial investment.
3. Programs. Items 8, 9, and 10.
4. Franchisee support. Item 11.
 - Site selection. Training. Operations Manual. Advertising.
5. General. Items 12, 13, 14, 15, 16, 17, 18, and 19.
 - Term.
 - Renewal.
 - Termination.
 - Transfers.
 - Covenant not to compete.
 - Arbitration.
 - Earnings claims.
6. Franchises. Item 20.
 - Number sold.
 - Number open.
 - Company stores.
 - Projected number of stores.
 - Number terminated. 3 years.
 - Who terminated. 1 year.
7. Company financial statements. Item 21.
8. Sample agreements. Item 22.

TYPICAL FRANCHISE SALES PROCESS

1. Prospect contacts the franchisor by internet, telephone or mail.
2. Franchisor responds by having a salesperson contact you.
3. Franchisor sends to you:
 - Brief letter and brochure and a Background Information Request Form, Sometimes you will receive at this early stage a detailed franchise sales folder or the Franchise Disclosure Document.
4. Prospect reviews information and sends in the completed Background Information Form.
5. Franchisor considers a Prospect's desire, experience, location preference, financial capability, and support of family.
6. Franchisor provides the Prospect with the Franchise Disclosure Document.
7. Prospect must prepare by
 - Reading the Franchise Disclosure Document completely,
 - Visiting the franchisor's office and meeting with the franchisor's personnel,
 - Contacting present and former franchisees, and
 - Having an experienced franchise lawyer review, negotiate and amend the franchise agreement.
8. Prospect signs franchise agreement and pays franchise fee. Site selection can occur before or after the franchise agreement is signed.

FRANCHISE LAWS

Federal and State laws regulate the sale of a franchise like the sale of a security.

Federal law -- Disclosure law.

State laws -- Disclosure law and registration law.

Receive a Franchise Disclosure Document at least 14 days before signing franchise agreements or paying any money.

The Franchise Disclosure Document describes 23 specific aspects of the franchisor and the franchise system. Provides audited financial statements on the franchisor. Includes sample franchise agreement.

The franchisor cannot legally sell you the franchise during the first 14 days after your receiving the Franchise Disclosure Document.

Relationship laws.

Termination laws.

The Franchise Laws:

Do not mean that the franchise will be profitable.

Do not mean that the franchisor is competent.

Do not mean that the franchise agreement is reasonable or fair.

Do not mean that the government believes this is a good franchise.

HISTORY OF FRANCHISING

Middle 1800's	Singer Sewing Machine
1900	General Motors Soft Drink Bottlers
1920's	A & W Root Beer Ben Franklin
1930's	Gas Stations Merle Norman Walgreen's Ace Hardware Arthur Murray
1940's	Duraclean
1950's	McDonald's 100 Franchise Systems
1960's	900 Franchise Systems
1970's	Federal Trade Commission's Rule on Franchising
1980's	State Franchise Disclosure and Registration Laws
1990 to present	3,000 to 4,000 Franchise Systems

FRANCHISE TERMINOLOGY

Franchising	Contractual relationship for name, support, fees
Franchisor	Parent Company. Leader. Mentor. Consultant.
Franchisee	The many individual business owners using the name and support. Local, independent marketing and distribution person.
Franchise Fee	One time, up-front fee
Royalty Fee	Ongoing service fee. Percentage of gross sales.
Advertising Fee	Ongoing advertising fee to national or local advertising fund. Percentage of gross sales
.	
Startup Costs	Construction, leasehold improvements, equipment, inventory
Franchise Disclosure Document	Disclosure document required by federal and state franchise laws
Franchise Agreement	Contract specifying rights and obligations of franchisor and franchisee
Franchise Operations Manual	Confidential operating and training manual

HOW TO BUY A FRANCHISE: A LAWYER'S PERSPECTIVE

By Michael R. Liss

"Franchising is the wave of the future," according to the U.S. Department of Commerce. John Naisbitt writes in *Megatrends*: "Franchising is the single most successful marketing concept ever." Should you consider going into a franchised business? And how do you become part of this success?

Let's start with the most important considerations: Before you buy a franchise, be sure you know yourself, the franchise program, and the franchise agreement.

KNOW YOURSELF

Do what you like. This is your chance to choose to do what you really want to do. Take the time to determine what you and perhaps your family would really like to do while working. You can choose a business you love. It is not just a job. Your business becomes a part of you. It is a reflection of you.

Work the numbers. Know what you can afford. How much cash do you have? How much can you borrow? How much does it cost to start this business? How much does it take to keep it going until it becomes profitable? An accountant familiar with business startups will be very helpful in preparing these numbers. Your preparation of a business plan will help you get ready. Investigate before you invest.

KNOW THE FRANCHISE PROGRAM

Be prepared. When you buy a franchise instead of creating a business from scratch, you can know much more about the business you are starting. You can prepare. You can determine if a particular franchise program is right for you. Your access to more information comes from many sources. You can visit existing stores. You can examine and purchase goods and services from franchises that are already in the program.

Franchisees tell you the truth. Call these franchisees and ask them the tough and detailed questions listed in the "Questions to Ask Existing Franchisees When Buying a Franchise" chart that accompanies this article. Existing franchisees are typically very open and honest in relating to you how they bought their franchise business. They will tell you what they like and dislike about the franchisor and the franchise program. Franchise prospects have told me stories about existing franchisees inviting them to come into their stores to actually review the store's profit and loss records. The existing franchisees remember how they wanted help when they bought their franchise, and now they want to help you.

Compare franchise disclosure documents. All franchise buyers receive a franchise disclosure document from the franchisor. It provides you with written information about the franchise program and the franchisor's company. Every franchise disclosure

document is made up of 23 Items, and the Items always appear in the same sequence. For example, Item 5 in every franchise disclosure document will tell you about the upfront fees involved in buying the franchise. You can easily compare one franchise to another by comparing the information in these 23 Items.

Franchisor background. The franchise disclosure document provides you with extensive information. Items 1 and 2 identify the franchisor's company, type of business, industry, and the experience of each of the franchisor's key personnel, whom you will be relying upon for support. You should contact the franchisor's personnel, visit their office, and determine if their knowledge is what you need and if they fit with your personality and style. Items 3 and 4 tell you about the company's litigation history and bankruptcies. Each lawsuit is summarized. You can tell what people are angry about, who is suing whom, and who is winning or losing.

Additional fees and costs. Money and cost information is in Items 5, 6 and 7. All the fees which you could be required to pay must be disclosed and explained. Item 5 is the upfront fees. Item 6 is the ongoing fees, like royalty and advertising charges. Item 7 is a chart that lists for you all the costs of going into this business. This information is very helpful in preparing your business plan.

Many franchisors make a significant amount of money by requiring you to buy products or services from them. This information and how much the franchisor makes are in Item 8.

Item 9 is a great cross-reference index to find various topics of interest. It tells you the Item number in the franchise disclosure document and the section number in the franchise agreement. For example, if you want to know if there is any sales quota involved, Item 9.k of every franchise disclosure document will answer that for you.

Financing. Financing information is provided in Item 10. This item tells you not only if financing is available, but what it costs, who provides it and what type of items can be financed. It even provides you with copies of the legal documents you would be asked to sign to obtain this financing.

Support. Many franchisees buy franchises in order to obtain support and guidance in both opening and running their business. All of this is in Item 11: Pre-opening training, operation manuals, site selection assistance, operational consultations, advertising programs, and computer requirements. By comparing franchise disclosure documents from different franchise companies, you can see what you will get for your money.

Your legal rights. The next few Items in the franchise disclosure document cover many of the nitty-gritty legal issues of owning a franchise. Key issues include such topics as how long you can be a franchisee for, how you could ever sell your franchise, non-compete requirements, how the franchise rights can be taken from you, your rights to cure defaults and keep the franchise, and even where and how disputes will get resolved.

Franchisee phone numbers. Some of the most important information is towards the back of the franchise disclosure document: A list of every franchisee, their locations and their telephone numbers is provided. You must call them. They can tell you the truth

about this franchise program. To know how financially strong this franchisor is, you are provided with three years of the franchisor's audited financial statements. If the franchisor is going to provide you information about how much money its franchisees make, it will be in Item 19. Most franchise programs do not and instead direct you to call existing franchisees to hear first-hand about money matters.

Finally, every contract, lease, or other legal document which this franchisor will ask you to sign is included in the back of the franchise disclosure document. You can read them now without being rushed.

KNOW THE FRANCHISE AGREEMENT

Read the franchise agreement, sublease, and other documents provided in the franchise disclosure document. You have time to read them because federal law prohibits the franchisor from rushing you to sign the contracts or pay money; in fact, the franchisor must wait at least 10 business days so you can get prepared.

Hire a franchise lawyer. You will need a franchise lawyer to work with you because the franchise program will need a careful legal review. Also, with most franchise programs, you can negotiate and change the terms of the franchise contracts to be fairer. The contracts start off one-sided because they are written by the franchisor. It is your responsibility to ask for the changes you want. A franchise lawyer will know what can be changed and how to negotiate for you successfully.

You can own a franchise and be part of the success if you:

- Investigate before you invest.
- You know what you want and can handle.
- Check out the franchise program with existing franchisees.
- Meet the franchisor's people who will be advising you and supporting your business.
- Carefully review the franchise disclosure document and franchise agreement.
- Hire a franchise lawyer to check out the franchise and negotiate the right terms for your franchise agreement.

Preparing now to make the right decisions will allow you to start and succeed in your own franchise business.

Michael R. Liss is a business and franchise attorney working to help businesses start and succeed. He is a frequent instructor at area colleges on buying a business, franchising, financing, and the legal issues which business owners must know. He can be reached toll-free at 888/372-6529.

HOW TO START YOUR OWN BUSINESS: A LAWYER'S PERSPECTIVE

By Michael R. Liss

What does it take to start a business? Guts, yes. Luck, yes. Perseverance, yes. What are the legal aspects of starting your own business? Do you know what your lawyer should be doing so that you can help him, keep him on track, and keep costs down? An overview of all the important areas would be very helpful, and that is what I propose to cover in this article. Some businesses will require a few extra items, but this list of eleven will cover most business startups.

Sources of Capital

It takes money to make money. You may have savings available, but if you are like most business startups, you will need extra money to get started. Whether you obtain the money as debt or equity, there will be a need to review the financing arrangements and the drafts of the necessary legal documents. Typical agreements prepared by the business lawyer are the promissory note, security agreement, stock or partnership interests, options, and any other documents needed to help you raise capital for your business.

Incorporation

How do you protect what you have already saved? How do you avoid putting all your personal savings at risk? How does your spouse become more comfortable with your starting this business? Should you incorporate your business? Incorporating your business, or if applicable, forming a limited liability company (LLC), can do a lot to help.

The primary reason people incorporate is to limit their liability: They want to protect their personal assets from business risks. This item on the legal checklist deals with choosing the best legal entity to own the business. Sole proprietorships and partnerships can own businesses but do not provide the owner with the limited liability protection that incorporation does.

The incorporation process is quick and inexpensive. It is typically a cornerstone that needs to be in place when you open for business.

Tax

Taxes are everywhere. As a business owner, you must learn about taxes and how to minimize them. Unless you plan right, Uncle Sam can become in effect your "partner," taking a large percentage of your profits. You need to know if being an S-corporation will be right for you, or whether an LLC would provide better tax savings both now and later. You need to apply for tax identification numbers. Federal and state tax requirements will be applicable. You will need to accurately calculate and pay your payroll taxes. Many

business owners soon find that a knowledgeable tax preparer and a payroll service can provide welcome relief from complex paperwork as well as enabling the business person to avoid penalties.

Books and Records

Do keep good business records and make sure they are current. Poor record keeping is one of the surest signals that a business will fail. If you are buying an existing business, then a review of three to five years of its financial statements will be critical to your understanding of the condition of the business.

Shareholders' Agreement

If more than one person owns the business, you need an agreement among those owners to cover topics such as what happens if one of the shareholders dies, becomes disabled or insolvent, or wants to sell his or her portion of ownership to an outsider. Shareholder agreements, buy-sell agreements, partnership agreements, or LLC operating agreements all spell out how to keep the stock closely held. If one shareholder dies, typically the corporation or the other shareholders are required to buy the shares from the estate, and the estate is required to sell the shares. The agreement specifies this requirement to buy and sell, the price, the payment terms and related obligations. If you are the sole shareholder of your corporation, you will not need a shareholders' agreement.

Trademark Registration

Choosing a name for your business not only has important marketing considerations but also legal requirements. Before you spend money on signs, brochures and advertising, you may wish to have searches done to verify no one else is using the name you desire. If you wish to prevent others from using your business name or your name for some of the products and services that you sell, then you should have a federal trademark registration done. It gives you strong legal rights throughout the United States. Every franchise business lives or dies on the quality of its name. Choosing the right name and being able to protect your legal rights to that name could be a major key to your success.

Real Estate Lease

Where will your business be located? If it is not at home, you will need permission from another person to use his or her location. This is what a lease is all about. The lease document covers where the location is, how long you can use it and what rent you will pay for being allowed to use it. The owner of the location will typically require you to follow certain rules when you are using his location. The lease covers termination: You must relinquish the location if you do not pay rent. With lawyers writing and rewriting leases, leases are getting longer. What may once have been two pages, can now easily be 82 pages. Since location could be the number one determinant of your business success, it is very important to have the lease carefully reviewed and written.

Franchise Agreement

Franchises make over a third of all retail sales. There is a good chance that if you are starting a business, you will want to consider buying a franchise. That way you can take advantage of a business name that is familiar to many people (a trademark) and support services to help you succeed. These benefits come with a cost: Up-front fees of \$10,000 to \$50,000 and ongoing royalty fees of 3% to 20% of all your sales. Review the pros and cons of your franchise opportunity with an experienced franchise lawyer. Negotiate the terms of your proposed franchise agreement. Be sure the amount of support and degree of control over how you run your business are what you expect and can live with. Contact many existing franchisees to get the inside story on the franchise. Investigate thoroughly before you invest.

Agreement for Sale and Purchase of Business

Past performance can be best indicator of future success. Therefore, you might consider buying an existing business. You will receive extensive information on how the business has performed in good times and in bad. You will be able to start immediately. You will probably be able to have seller financing, so there is a built-in source of capital. You will have experienced employees already at work for you. The advantages of buying an existing business can be great, but finding a business to buy can be a difficult and frustrating task. Professional advisors like lawyers, bankers, accountants and business brokers can be helpful, but sometimes you have to just go and knock on doors of businesses that interest you to see if the owner(s) might be willing to sell. The legal document for buying a business is most typically called an Asset Purchase Agreement. It spells out what you are buying, the price and the payment terms. It also describes the condition of the business in great detail. The goal is to check out the business as much as possible before buying it. You want to get what you expect. You want to avoid skeletons in the closet. The Asset Purchase Agreement is the device that protects you as you purchase the business.

Commercial Contracts & Equipment Leases

Many businesses have important items to purchase or contracts for services or products they sell. These contracts are the lifeblood of the business. If the contracts allow payments over time, like an installment sale contract or an equipment lease, then a careful review of the default and cure provisions is necessary. For the sake of making sales and not scaring off potential customers, these contracts must be user-friendly. That means your business lawyer needs to write clearly, simply and in standard English.

Employee Issues

People are probably the most important asset of any business. How you attract and keep talented and dedicated employees will be one of your most important challenges as a business owner. What compensation will you provide? What benefits? Will a key-employee become a co-owner? Employment agreements can assure the key employee that he should come on board with you and become a top performer.

There are many important pieces in the puzzle of starting a business successfully. Legal issues are one of those pieces. The eleven issues discussed here cover the most important legal areas you will need to cover in order for you to start and succeed in a new business.

Michael R. Liss is a business and franchise attorney working to help businesses start and succeed. He is a frequent instructor at area colleges on buying a business, franchising, financing, and the legal issues which business owners must know. He can be reached toll-free at 888/372-6529.