H.E.L.P.: How to Franchise a Restaurant Concept in the U.S.

By Rochelle Spandorf © 2021

Congratulations! You have decided to expand your restaurant brand's footprint by harnessing one of America's most popular business expansion engines – franchising! Your next job is to become familiar with the business considerations and legal compliance challenges that lie ahead. Exactly what is involved legally speaking to become a franchisor? What will ensure your franchise program the best chance of success? How much should you initially budget for legal compliance costs? How long will the launch process take?

These are the most frequently asked questions of every startup franchisor. Here is a roadmap for launching a franchise program the smart way.

1. **Protect Your Trademarks and Other Intellectual Property.** The cornerstone of your franchise system is your brand name. If you have not already registered your restaurant's name and logo with the U.S. Patent & Trademark Office, protecting your intellectual property, foremost your restaurant's name, is your first legal compliance step. Not all brands are protectable, and you will need an attorney knowledgeable in trademark prosecution to advise you especially if a due diligence search reveals others already using the same or a confusingly similar name nearby or in markets where you hope to expand. A trademark attorney can also advise you about other important intellectual property rights that you should consider protecting, for example distinctive trade dress features like distinctive building attributes or interior décor, menu names and recipes.

2. **Know the Law!** A franchisor's principals are each jointly and severally personally liable for franchise sales violations in the U.S. even when the franchisor is a business entity or the violation is committed by an outsourced sales broker, not the franchisor's employee. Selling franchises in the U.S. is subject to federal and state laws that require extensive pre-sale disclosure via a comprehensive franchise disclosure document (FDD) that must be delivered to a prospective franchisee at least 14 days before a franchisee may lawfully pay even a refundable deposit or sign a binding agreement to buy a franchise (even a cancellable option). Because of personal liability risks, a startup franchisor should assign a member of its management as the franchise company's franchise compliance officer to interface with the company's franchise counsel, learn the road rules, implement best practices, and oversee company-wide franchise sales practices including by outsourced sales brokers. The penalties for violating franchise sales laws are potentially costly not just in dollars, but also to the franchisor's continued ability to sell new franchises. If you want to be a franchisor, you must learn to play by specific rules. You must become acquainted with the long list of information that must be in your FDD, know the information that the law forbids you share with a candidate unless the information is in the FDD, and know the rules for delivering the FDD to document a candidate's timely receipt. You need to know when you must update your FDD, and what you may tell a prospect about how well our own restaurants perform if you do not make a financial performance representation in the FDD. The rule book is long.

3. **Hire an experienced U.S. franchise attorney.** Franchise law is not for dabblers. While most attorneys with a general commercial practice are familiar with trademark licenses, they may not know the difference between a non-franchise license and a franchise license. Because franchising is a specialized field of law with steep consequences for making mistakes and no legal defense for not knowing the law, you will need to hire an attorney experienced in representing franchisors to guide you and your management team on your legal responsibilities. Avoid buying franchise packages with generic legal documentation or "all in one" services as these packages will not help you critically vet all of the decisions involved in designing a franchise expansion platform or answer your franchise sales compliance questions.

4. **Create a Competitive Franchise Program.** You will be competing with many franchisors for the same pool of candidates including established brands. Your prospects may not just be shopping restaurant franchise programs by cuisine or market segment; they may be shopping across business opportunities by price. How can you distinguish your restaurant brand and franchise program to convince pioneer franchisees to take a chance on you? For starters, get familiar with how restaurants franchisors with far more experience structure and explain their franchise program in their FDDs. A dozen states require franchisors to register annually with a state agency in order to sell franchises for locations in the state and three of these states, California, Minnesota, and Wisconsin, have public databases where you can find FDDs. Access to these materials is free and offers unfiltered insight (start with Minnesota). Here you will find competitive intelligence about your competitors' franchise fees, franchise contract terms, financial performance representations, litigation within the franchise system, marketing and training programs, revenue from mandatory sourcing restrictions, franchisee turnover statistics, and more.

5. **Prepare a FDD that Gives You an Edge.** The FDD is the most comprehensive explanation of your franchise program. While chiefly a legal document, it also performs a marketing function. A classic mistake of start-up franchisors is not using the FDD to highlight their franchise program's distinctive attributes to differentiate their franchise opportunity from others. Because FDDs are a matter of public record (see #4), it may be tempting to lift pieces of your FDD and franchise contracts from other specimens and cobble text together and create a "Plan Vanilla" FDD just to get by. A hacked FDD will not reflect the structuring decisions you need to make to accomplish your business goals. For example, should you offer a multi-unit franchise option that allows franchisees the chance to build-out a market area and, if so, at what cost and development rate? Is a "development agent" model, the approach that catapulted Subway's growth, the right expansion platform for your brand? Should you help your franchisees accelerate their onboarding and opening date by offering a turnkey package? An experienced franchise attorney will guide you through these and many other business considerations to help you create a legally compliant FDD that puts your restaurant brand's best foot forward.

6. **Set Business Terms That Allow Franchisees to Succeed.** Franchisors write the franchise agreement and possess contract power over the brand license. However, using contract power to write a one-sided contract is a shortsighted, combustible approach for launching a franchise program. For many reasons, it is important that your franchisees be profitable. Not only are franchisees ambassadors for the franchise brand, but a franchisor's easiest next franchise sale is to an existing franchisee. Financial distress is the single greatest cause of unhappy franchisees. Widespread financial distress across multiple franchisees in the same network suggests the root cause may lie at the helm with the franchisor. Do not dismiss complaints from multiple

franchisees who follow your business model, yet say they cannot make a living or had to invest far more than your FDD said it would cost them to open their doors. Do not use franchisees as guinea pigs to launch untested programs without rewarding them for vetting your new concepts. Listen to franchisee feedback and do not be afraid to rethink franchise terms that have not worked out of concern that it will portray you as the weaker contract party.

7. **Stick to the Script!** Franchise sales laws allow you to negotiate the terms of your franchise agreement, but treating franchisees differently can have internal ramifications notwithstanding an airtight confidentiality agreement. Assume your franchisees will compare notes. Negotiating your franchise agreement makes perfect sense when dealing with the right franchisee candidate, but you may not present candidates off the bat with different fees, contract terms or investment costs in face-to-face meetings, marketing materials or on your webpage than what your FDD says. A mismatch between your FDD and these other sources of information may expose you to legal risks and enable a plaintiff to portray you unsympathetically to a jury as disdainful of franchise laws.

8. **Choose Franchise Candidates Wisely.** Be selective: do not sell a franchise to anyone just because the applicant is a loyal customer or shows interest in your brand. Franchise arrangements are long-term; in the restaurant space, 10 years is the typical length of an initial franchise term with one or more franchisee renewal options. Set appropriate minimum net worth, liquid capital and experience requirements and resist the temptation to deviate. Your ideal candidate should have experience in the financial and operational aspects of owning a restaurant even if you excuse the franchisee's owners from being active in day-to-day affairs. Since the hardest franchise sale is the first, consider offering the first 10 franchisees that sign a franchise agreement a significant discount on the initial franchise fee as a way to incentivize and reward the earliest adopters. Do not worry about awarding franchises to professional multi-brand franchisee that operate in other franchise systems or have a higher net worth than your do: their record of accomplishment should credential your brand and help you attract other franchisees.

9. **Budget Wisely!** Being undercapitalized is the number one mistake of start-up franchisors. You will need a sound business plan in order to embark on franchising the right way! There will be legal fees to prepare the FDD and franchise agreements; more legal fees if you open franchises in states with annual registration requirements; accounting fees; filing fees; and marketing expenses to generate initial franchise sales. You may want to secure business advisory services from consultants who specialize in franchising and help startups prepare realistic financial models. Experts say "all in" a startup franchisor should budget between $150,000 - $200,000 to launch a franchise program, and from this legal and filing fees realistically will range between $40,000 - $75,000 in the first year.

10. **How Long Will It Take to Launch a Franchise Program?** It typically takes a diligent management team working with experienced franchise counsel 3 to 4 months to complete the preparation of the FDD and standard contracts and another month from the date that registration applications are filed to secure state registrations assuming both client and attorney are responsive to one another during the planning process and state franchise agencies process the application efficiently without flagging too many deficiencies. There is no way to accelerate the state registration process or pay an extra filing fee to get on a faster track. Structuring a franchise program properly requires that you dedicate appropriate time to review and consider complex legal documents since, by delivering an FDD, you represent to a prospect that everything in the FDD is materially true, correct and not misleading. Unless a member of your management team has been around franchising before, the information that you will need to assemble and the decisions you will need to make will take time to absorb and answer thoughtfully in a way that fits your company's business objectives and resonates positively with prospective franchisees.

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