

LIABILITY:

Where does the franchisee stand?



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Now that you have found the type of business that both fascinates you and will provide you with a great income, it is time to consider two of the givens of any contractual relationship: The limitation of liability and incurred liability.

1. The limitation of liability

The recitals or background provisions of a franchise agreement contain a number of statements that record what the 'history' of the relationship is together with a number of acknowledgements by the franchisee such as:

'At the guarantor's request' which ties in the directors of the franchisee company to the guarantee.

The importance of maintaining the required standards.

The importance of following the prescribed procedures.

When buying a franchise it is important to remember that you are buying into (amongst other things) a system or method of doing business. If you do not comply with the system not only will you have wasted part of your money and risk being in breach of your franchise agreement, but it is most likely that your franchise will not succeed. Therefore if you have acknowledged these two things mentioned above they will constitute a hurdle for you to leap over should you wish to issue legal proceedings against the franchisor for any loss of money. All this makes complete sense.

- **Premises**

If your franchise requires you to lease premises from which to operate the franchise, the franchise agreement will state that (no matter how much the franchisor has assisted you in choosing the premises) that it is your responsibility

to be satisfied with the suitability of those premises. Whilst the franchisor is likely to have vastly more experience than you in choosing premises, the franchisor does not wish to lay itself open to a claim by you in that, your business failed because the franchisor chose you the wrong place to operate from. Business failure can result from a number of factors and the franchisor, understandably, wishes to focus on growing and improving the business rather than fighting unreasonable/unjustifiable claims made by dissatisfied franchisees. Remember when buying or operating any business, the buck stops with you – and this is no different in franchising. Fortunately when you buy into a well established franchise system your chances of failure are significantly reduced and your chances of success on a continuing basis are significantly increased.

- **Independent Advice**

To assist you in making an informed decision as to whether to buy a particular franchise it is critical (and the franchise agreement will record) that you receive or have been given the opportunity to receive or that you have decided not to receive, advice from an independent lawyer, independent accountant and independent business advisor) Obtaining such advice from people who are thoroughly familiar and knowledgeable in the field of franchising is most important to your financial wellbeing. This independent advice acknowledgement helps limit the franchisor's liability and places the risk (to a certain extent) back on you and your advisors.

- **Acknowledgements**

Any reasonably prepared franchise

agreement will contain an 'acknowledgement' clause. Such a clause will state:

- (a) you have conducted an independent investigation of the business
- (b) that you acknowledge the venture involves business risks
- (c) that you acknowledge the venture's success depends on your ability
- (d) that you acknowledge that you rely on no representations or warranties given by anyone other than those representations or warranties contained in the franchise agreement.
- (e) that you acknowledge that you have not received any representations or warranties as to the profits or success of the venture.

- **Indemnity**

You will agree to indemnify the franchisor from any loss etc arising out of or in connection with the operation of the franchised business. Indemnify means 'to compensate for damage, loss sustained, expense incurred' suffered by the franchisor. This is clearly a franchisee liability. Once again you need to obtain assurance that 'all is well' with the product/services you are licensed to provide under your franchise.

- **Liability for costs**

You will be liable for any costs incurred by the franchisor as a result of your breach of the franchise agreement. This will include legal costs.

2. Incurred Liability

As mentioned before any contract is likely to create obligations, liabilities and hopefully benefits.

The liabilities you may incur as a franchisee

include the obligations to:

- (a) pay the initial franchise fee
- (b) pay the ongoing franchise fees
- (c) pay for stock, products etc (on given terms)
- (d) pay rent and outgoings on any premises
- (e) complete a refit of any premises as and when required and maintain those premises to a required standard
- (f) employ adequate staff
- (g) spend a specified amount on local marketing
- (h) pay the national marketing levy
- (i) achieve minimum performance standards.

These all might be described merely as obligations but they are also obligations that create a financial liability.

• **A Restraint of Trade**

Whilst this is a negative obligation nevertheless it is a liability in that it could cost you dearly. What is a restraint of trade? It is an obligation not to be involved in any way in any business that (generally) competes with or that is similar to the franchised business.

You will be restrained from being involved for:

- (a) a certain term (of years); and
- (b) within a certain area.

The liability incurred is that if you wish to carry on doing something similar to what you did under your franchise then you may have to move town/country to do it. It can cause a particular hardship if, for example, you are an electrician and you are going into an electrician's franchise. Do not forget that you will not, in any circumstance, be permitted to use any part of the intellectual property and/or confidential information specified in the franchise agreement.

• **Personal Liability**

If you have created a company to be the franchisee then it is most likely that the franchisor will require both the directors and shareholders to provide a personal guarantee to the franchisor for the performance of the franchisee's obligations. Similarly if you are to rent premises the landlord is likely to require you to provide a similar personal guarantee as will various suppliers to the business. Any bank loan obtained is likely to have, as a condition, the requirement for the

directors/shareholders personal guarantee and it is likely that any bank loan to your new business will be required to be secured over the family home.

This liability is to be expected (but not necessarily to be accepted without question) in virtually any business operation. It is most important that your business and personal structures and asset ownership arrangements are considered by your solicitor (preferably in conjunction with your accountant) before you embark on a charge into owning your own business.

Conclusion

As with any business venture, it is most important that you obtain appropriate legal and accounting advice and it is strongly recommend that you look at the service providers listed on the FANZ website for appropriate advice. ❖

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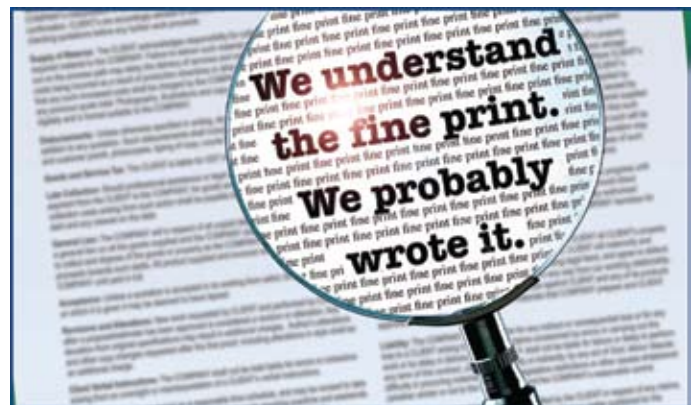
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