

How to future proof your franchise agreement

Why now is the time for franchisors to ensure their manuals are up to date and include any recent changes made to its 'system'

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The past year has shown that the franchising business model is both resilient and adaptable.

Whilst many businesses have suffered, some have actually thrived and been lucky enough to benefit from a surge in demand. Others have had to be more creative and figure out how best to adapt during a pandemic. Unable to rely on foot traffic, they've had to develop new and alternative ways to reach their customers, such as:

- Creating digital and virtual offerings
- More efficient or cost-effective ways to deliver goods or services
- Discovering new products or revenue streams

For some franchisors, this shift in operations might only be temporary. But for others, experimenting with new ways of working has made them think twice about how they currently run their business – and could result in long-

term improvements for their whole franchise network. But how do you incorporate such changes into your franchise agreement and make it future proof?

Incorporating system changes

While a franchise agreement generally cannot be varied during the term without the consent of both parties, the franchisor is entitled to update its operations manual from time to time, as need requires. The rules, regulations, standards and processes in the manual are not set in stone, and the franchise agreement will make clear that it is subject to change as the business grows and develops, particularly if the franchisor is in the early stages of expansion.

Now is the time for franchisors to ensure their manuals are up to date and include any recent changes made to its 'system'. For example, adjustments to allow for takeaways and home deliveries, changes to account for new products and/or services, the incorporation of new health and safety measures in line with government guidelines, social distancing measures and the use of virtual communications as an alternative to face to face meetings and franchisee conferences.

Changing the franchise agreement

There is a difference between operational changes – which can rightly be amended via the manual – and attempting to vary key terms of the franchise agreement (such as the duration of the agreement, a franchisee's renewal rights or the agreed royalty fee structure) via the

'back door'. Key contractual changes can be amended with consultation and agreement with your franchisees, especially if they are in the franchisee's interests. Failing that, the opportunity to make such changes is upon renewal, when franchisees will be required to sign your then, current standard agreement.

New franchisees coming on board would sign the new version from the outset and there may be a period of inconsistency between the terms applicable to different franchisees, which will need careful management.

Franchisors may wish to consider giving themselves the right to amend the agreement unilaterally in order to comply with a change in the law affecting the franchise sector, especially as many of the changes flowing from Brexit are currently unclear as the U.K. government decides which laws to retain and which to remove or amend.

Future proofing in this way will require solid internal processes to ensure that renewals are dealt with efficiently and that you are kept abreast of the latest legal developments impacting franchising. While your franchise lawyer can keep you updated as to changes in applicable law, in turn you need to keep your lawyer informed of any commercial updates you are considering, so they can advise you how best they might be incorporated.

Planning for business disruption

Going forward, franchisors should be reviewing their franchise agreements with a focus on provisions that apply in the event of significant business disruption. The reality is that we

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could be dealing with coronavirus for some time to come – whether in the form of continued COVID-19 infection, in the U.K. or elsewhere, further spikes of infection, new variants or developments of other coronaviruses.

Franchisors need to consider how their franchise agreements can best protect them against future shocks and what changes they ought to make.

Events beyond your control

A typical force majeure clause suspends – and may even end – performance of obligations where a party is prevented from performing by events outside of its reasonable control. The pandemic shone a spotlight on this standard, and often overlooked, boilerplate clause. During the pandemic, relief under the principle of force majeure has been sought in answer to the following thorny issues:

- Is the franchisee in breach by not operating the franchise business even though they have no customers?
- Is the franchisor in breach by not providing its support obligations during lockdown?
- Is the franchisee still liable to pay minimum royalty fees even though they have no revenues?

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Up until now, force majeure clauses have been drafted widely and can often lack detail as to what exactly should happen in the event of force majeure. Going forward, force majeure type clauses should deal specifically with pandemics (although arguably they are no longer an ‘unforeseen event’) and should be clearer as to the rights of the parties to suspend, renegotiate or terminate. Such clauses should also deal specifically with the corresponding payment obligations, how long any period of relief should continue for, and how the contract

is able to return to its previous state after the force majeure event has passed.

Electronic signatures

COVID restrictions have presented logistical challenges when it comes to getting franchise agreements signed in person or sent via post. Currently there is a trend towards electronic signatures for contracts which overcomes such challenges, as well as having the added benefit of getting a deal done more quickly.

Franchise agreements can be signed electronically, but anything that needs to be signed ‘as a deed’ cannot. This is





because deeds must be signed by hand in front of a witness who then provides their own signature by hand. When a witness signs the deed, they are confirming that they have physically witnessed the requisite party sign the document in their presence.

Sometimes the personal guarantee (given by the individual(s) behind the franchisee company) within a franchise agreement is signed 'as a deed' to offer enhanced protection that the guarantee is enforceable. Legal advice should be sought as to the options available to a franchisor and will depend upon whether or not the personal guarantee aspect sits inside or outside its main franchise agreement. To be belt and braces, a franchisor wishing to move forward with electronic signature of documents should also add a clause to the franchise agreement permitting this.

Service by email

Now is also a good time to look at another, often ignored, provision of your franchise agreement regarding the service of notices. Only a minority of franchise agreements provide that legal notices can be served by email, especially if they are a few years old. In fact, some agreements still provide for service by 'facsimile transmission,' despite hardly anyone still owning a fax!

Step-in-rights

You should consider whether your agreement should contain 'step-in-rights' allowing you to step in and run the business in the event of termination or expiry of the agreement, in order to preserve continuity of service to

the franchisee's customers. Many agreements permit this, especially where franchisee premises are involved, but many do not.

Due to a recent change in the law, it has now become difficult (or impossible) for a franchisor to terminate the agreement on the ground that the franchisee has entered a formal insolvency procedure. Therefore, the franchisor now needs to have the right to be able to terminate at an early stage in a franchisee's financial problems – before it has taken any step towards an insolvency process – where the franchisor has a reasonable belief that the franchisee is in financial difficulty. This is likely to require a drafting change to your standard agreement and may offer some additional protection to the franchisor.

Dispute resolution

Finally, does your agreement set out a specific process to be followed in the event of a dispute between franchisor and franchisee? For instance, should the matter first be escalated to senior personnel in each business? And if that fails, can an independent third party step in to avoid deadlock? Note for U.K. franchisors, the British Franchise Association offers a mediation service. Having such contractually specified steps could help avoid time consuming and expensive litigation.

In my experience, parties don't wish to address 'what happens

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if things go wrong' at the outset of their relationship, but giving this some proper consideration and incorporating some sensible provisions to follow in worst case scenarios could prove well worth it.

A QUICK GUIDE TO FUTURE-PROOFING

- 1 Use the agility of the manual to build in operational changes.
- 2 Unless the parties can agree otherwise, fundamental contractual changes will need to be implemented on renewal and for new franchisees. Careful management and robust processes will be required.
- 3 Focus on provisions that would apply in the event of significant business disruption or worse case scenarios. Force majeure, step in rights and dispute resolution procedures will all be important.