



Key concerns in succession planning

Michael Einbinder ♦ Today's Restaurant Contributor

Michael Einbinder of Einbinder & Dunn, franchise lawyers representing both restaurant franchisors and franchisees, discusses what a restaurant franchise owner should be aware of before transferring a franchise to a third-party purchaser or an existing business partner or leaving it to family members (a process frequently referred to as succession planning).

This topic comes up often for owners and is tricky because of the involvement of multiple parties – the franchisor (or franchisors), a landlord (or landlords), existing business partners and possibly creditors.

Franchisees with multiple units within the same system or multiple concepts across different franchise systems are facing a unique set of concerns. For those franchisees with multiple restaurants within the same system, additional complications may arise because the form of franchise agreement for each restaurant might be different because franchisors often revise their franchise agreement over time. For those franchisees with restaurants in multiple systems, difficulties result from a lack of uniformity across franchise agreements.

In either case, significant consideration must be given to the transfer provisions found in the leases as they are likely to vary greatly. Restaurants franchisees and even more so multi-unit and multi-concept restaurant franchisees are unlike other businesses when it comes to succession planning or liquidity events.

Franchise Agreements - Various Versions

The most important difference is that franchised businesses have an additional contractual layer that does not exist in other businesses – they are bound by franchise agreements. Any franchisee considering transfers will have to comply with provisions of those agreements that address their ability to transfer their businesses to successors or to third parties.

For multi-unit franchisees, they are often bound by different iterations of the franchise agreement, which the franchisor has revised over time and which may contain different restrictions on transferring that franchise.

Restaurant franchisees that are in more than one system will have signed different franchise agreements, which will certainly contain different restrictions on transfers.

It is critical to get franchisor approval when planning restaurant transfers.

For franchisees that are planning on transferring their restaurants, the first step is to conduct a thorough review of their franchise agreements and determine what restrictions and/or obligations apply. Next, franchisees should formulate a plan to handle those restrictions and/or obligations.

It is critical to get franchisor approval when planning restaurant transfers. The earlier a franchisee can get the franchisor to buy into the franchisee's succession plan, the more successful that plan will likely be.

In fact, some franchise agreements may require franchisor approval before the franchisee even approaches prospective purchasers or transferee or before the franchisee finalizes a deal with a prospective purchase or transferee.

In many cases, franchise agreements reserve certain rights for the franchisor, including but not limited rights of first refusal, rights of first offer, rights to purchase the restaurant upon the death or disability of the franchisee's principal and other similar transfer rights.

When formulating your succession plan, it is important to understand what rights have been reserved by your franchisor(s). This information will be critical in determining how best to accomplish your plan.

Real Estate Issues

Most restaurant franchise systems are retail real estate based. If the franchisee owns its building or properties, that may make any transfer less complicated, but that is atypical.

If the franchisee leases its retail locations, lease provisions relating to assignments of leases and change in control of the franchisee entities is a complicating factor to any succession plan.

The real estate aspect of the business of multi-unit and multi-concepts franchises is also complicated because of the number of properties/leases at issue – all of which may contain varying restrictions on transfers/assignments or other problematic clauses.

For example, some leases require that the landlord be compensated for an assignment of a lease. If the clause is narrowly tailored so that the franchisee is only compensating the landlord for the value received in exchange for the assignment of the lease, the clause is not that troublesome.

However, when the landlord's compensation is not tied to the economic value of the lease, but broad enough to include the value of the entire purchase price of the restaurants, the franchisee has an issue.

Other leases may prohibit the outright transfer of the lease without the landlord's consent, which may be withheld for any reason. This creates uncertainty when planning to transfer the restaurant either by itself or as part of a larger transaction. Without securing consent from the landlord, the entire deal may fall apart.

Principals of franchisee entities are often times obligated to give some kind of personal guaranty on

real estate leases. When negotiating a sale to a third-party purchaser or to an existing business partner or when leaving the restaurant to family members, the principals should pay careful attention to the guarantees that they have in place with their real estate leases or otherwise.

Plan Ahead

The best thing to do is to plan ahead. An analysis of relevant franchise agreements and lease is key if a restaurant franchisee is considering a transfer or sale, even if that event is not in the immediate future.

Once the franchisee has a general game plan, it is also recommended, even at an early stage, that the franchisee work with its franchisor (or franchisors) to get feedback on its succession plan.

Franchisees would also be best served to review their financial books and records and make sure that everything is in order in the backend.

Closely held companies, such as franchisees, often do not spend the time, money or effort to ensure that their financial books and records can be easily reviewed by potential purchasers. This mistake can be costly to the franchisee.

It could result in potential purchasers walking away from a deal because the financial books and records are too difficult to decipher or peculiarities cannot be explained or refusing to offer a higher value for the business because of uncertainties.

If a franchisee is committed to doing a deep dive into their legal documents (franchise agreements and leases) and their financial books and records, that franchisee has given himself/herself a terrific opportunity to effectuate a successful succession plan. 

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