International Distribution Institute

Negotiating the termination of franchising contracts

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I. What you should have identified at Due Diligence phase

1. Identity and corporate structure of the franchisee
2. Clauses of the existing store lease agreements

II. What you should have anticipated when drafting and negotiating your Franchise Agreement

1. Reasonable notice period
   - To allow negotiations to take place
   - To limit indemnification rights in favor of the Franchisee
   - To ensure a smooth transition to termination and take over
2. Clear regulation of the date of effects of termination

3. Recourse to discussions at top management level
4. Mediation measures
5. Clauses of the sub-franchise agreements
   - Permitting the take-over of the franchise business in an straightforward manner
   - Ensuring termination of the sub-franchise agreements upon termination of the Master Franchise with: (i) automatic and immediate effects, and (ii) no liability for the Franchisor
   - Ensuring indemnity to Franchisor regarding the effects of termination for the sub-franchisees, employees of the Franchisee and sub-franchisees, tax authorities, labor authorities, and third party creditors

6. Call option regarding the take over of the Franchisee Business
   - Valuation for price purposes
   - Timing
   - Beneficiaries: Franchisor or other franchisee or Master Franchisee
7. Prohibition to give the shares/assets of the franchise business as security to third parties without Franchisor's authorization

8. Stock repurchase provisions
9. Enforcement actions for removal of signs and furnishment
10. Sett-off of credits and debts
11. Pre-termination covenants
12. Post-termination clauses:
    - Non-compete, Non-solicitation and Confidentiality
    - Restrictions regarding the use of the store after termination
13. Proxy rights to de-register IP rights
14. Access to customers' data
15. Clauses in favor of the Franchisor for the enforcement of some of the above actions *versus* the sub-franchisees

III. What you should be aware of when anticipating a termination event

1. Termination may need to be confirmed by a court
2. Enforcing post-contractual clauses may require judicial action
3. Enforcement actions regarding Franchisee’s post-termination obligations may not be available in some jurisdictions
4. Difficulties to enforce call options regarding the franchise business
5. Enforcement of a call-option could be subject to claw-back actions in the event of insolvency of the terminated franchisee

IV. What you should take care of when anticipating a termination event

1. Limit the flow of confidential information
2. Employment risks
3. Status of the balance of payments between the parties
4. Stock in franchisee possession
5. Refrain from requesting/authorizing investment actions by the franchisee
6. Monitor closely new openings
7. Monitor acquisition of new rights regarding leases
8. Check whether assets are encumbered/given as security and the amount of secured debts

V. What you should negotiate upon termination

1. Assignment of sub- franchise agreements
2. Deadline to cancel registration of IP rights/proxy in favor of the Franchisor to do so
3. Purchase of the Master Franchisee IT system
4. Stock re-purchase: price, conditions, timing and obligations regarding the giving away of the remaining stock by the Franchisee
5. Purchase of franchise furnishment and materials
6. Deadline and cost to withdraw franchise identification signs
7. Liquidation of the Franchisee's employees
8. Full waiver of compensation rights
9. Full settlement of debts and credits

10. Guarantees for delayed payments
11. De-identification of the Franchisee
12. Return and destruction of confidential information, operating manuals and franchise materials
13. Post-termination internet issues
14. Restrictions on the use of the store after termination
15. Obligations regarding the use of the Franchise trade dress, menus and recipes post termination
16. Indemnities regarding third parties' actions

VI. Negotiating the taking over of the franchisee business

1. Common issues
   - Drawing a clear line regarding the Parties' liability for pre-closing action
   - Covenants between signing and closing
   - Non-compete and non-solicitation obligations
   - Confidentiality
2. Share deal
   - R&W's regarding P&L, sub-franchisee agreements, tax and employment
   - Price adjustments
   - Change of control provisions (leases)

3. Asset deal
   - Sale of business as an on-going concern *versus* sale of assets
   - Lease agreements and option rights
   - Subrogation regarding the Franchisee's employees / Transfer of key employees
   - IT systems
   - Web pages and domain names
   - Marketing and advertising funds
   - Assignment of customers data bases and information
   - Assignment of customers rights: product return, cool-off periods, gift cards

- Call centers and telephone numbers
- Accounts payable and receivables
- Assignment of legal actions initiated by the Franchisee regarding sub-franchisees agreements and IP infringements by third parties

4. Enforcement of call options
    - Involves substantial legal uncertainty
    - Feasible when call concerns shares, more difficult when it concerns assets or the business

Thank you for your attention

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