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# Enforcement and Risks of Post-Termination Buybacks and In-Term Step-In Rights

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**Patrick J. Maslyn**  
Kaufman & Canoles, P.C.  
Richmond, VA

**Morgan Ben-David**  
AXS Law Group, PLLC  
Miami, FL

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## I. INTRODUCTION

The relationship between a franchisor and franchisee is inherently temporary. A franchisee is granted the right to operate under a franchisor's business model for (typically) a defined term. If a franchisee is granted the right to renew the term of its agreement with the franchisor, its rights to extend the original term are normally limited. Even during the term of the franchise relationship, there is always a degree of uncertainty that exists for the franchisor because the operation of the business is dependent upon another party – the franchisee. If that relationship sours, or the franchisee defaults, or if the franchisee cannot continue to operate the business for some reason, the continued operation of the business at the franchisee's location may be in jeopardy. So, eventually, nearly all franchise relationships will reach a point where the franchisee's rights to operate the business will end, and the franchisor must face a number of questions relating to what should be done with the franchisee's unit. Is the location still a good location for the brand? Is it profitable? If not, could it be? If the business closes, will there be damage to the brand? Does the franchisor still want to be in the business of franchising?

If the franchisor decides that keeping the business operating at the franchisee's location is in its best interests – and the best interests of the brand – it may elect to take over the operation of the business at the franchisee's location. To do so, franchisors typically incorporate several contractual rights into their franchise agreements (or ancillary agreements) intended to enable the franchisor to take over the operation of the franchisee's business. This paper attempts to: (1) identify and explain some of the key mechanics of the franchisor's exercise of these rights under each of the typical circumstances that give rise to them, (2) highlight the risks, difficulties and opportunities that exist in the event the franchisor elects to exercise them, and (3) note important tips for franchisors, franchisees and their counsel in preparing for and implementing the exercise of these rights.

## II. IN-TERM STEP-IN RIGHTS

### A. Under What Circumstances Can and Should a Franchisor Exercise Step-In Rights?

It is common for franchise agreements to contain provisions granting the franchisor the right to assume operation and/or management of a franchisee's business during the term of the franchise agreement under certain circumstances. Examples of common events triggering a franchisor's contractual step-in right include:

- Death or disability of the franchisee or franchisee's owner;<sup>1</sup>

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<sup>1</sup> See, e.g. Ultimate Fitness Group, LLC Franchise Disclosure Document, Franchise Agreement § 11(b) (Apr. 18, 2018), available at <https://www.cards.commerce.state.mn.us/CARDS/security/search.do?documentId={DDAFBF6C-E759-4D35-9C13-C131C9BD32F2}> (“[I]f at any time following death or Disability of you or one of your Owners, we determine that the Studio is not being managed properly according to our System Standards, we or our designee have the right (but not the obligation) to enter the site and assume the Studio's management for any period of time that we deem appropriate.”).

- Where there is no qualified manager in place to operate the business;
- Where the franchisee abandons the business or is absent;<sup>2</sup>
- If a franchisee's actions threaten the goodwill or reputation of the franchisor, its marks, or the system;
- During times of a franchisee's non-compliance or default under the franchise agreement.<sup>3</sup>

Ultimately, a franchisor's objectives in exercising its step-in rights should be designed to ensure the continuing operation of its franchises, where possible, and to ensure that the brand and others are not detrimentally affected. Depending on the industry involved, especially where health and safety, or the children or elderly are concerned, a franchisor may take a more hard-lined approach to taking over control of a franchisee's business in order to prevent damage to the brand and to third parties. For example, Kumon®, which offers franchises to operate after-school education centers for children, has specifically-crafted step-in rights to take into account the unique nature of operating a school and servicing children. Specifically, Kumon®'s franchise agreement gives the franchisor the right to step-in if: (a) the franchisee is absent from the center without making adequate arrangements in advance; or (b) if the franchisee or any of its owners or employees "is charged with a crime against children or involving moral turpitude" or engages in any conduct that is "susceptible of creating a crisis or immediate substantive damage to the Kumon Brand."<sup>4</sup> The management fee charged by Kumon® is based on a formula taking into account tuition prices and numbers of students enrolled, while the duration of the management period will be for so long as the franchisee is absent, or for so long as the public relations crisis has ended, or until a disposition of the franchisee's case is reached, as applicable.<sup>5</sup> By exercising step-in rights in these circumstances, a franchisor is able to not only prevent reputational harm and contain potential risk but can also distance the brand from a franchisee who has engaged in illegal, unsafe, or harmful conduct.

Even where a franchise agreement is silent on the issue of a franchisor's step-in right, there may be situations where it is practical or beneficial for the franchisor to manage the franchisee's location for a certain period of time or for so long as the franchisor deems reasonable. Indeed, in circumstances where a franchisee is in default,

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<sup>2</sup> See, e.g. Smashburger Franchising, LLC Franchise Disclosure Document, Ex. C – Franchise Agreement, § 14.C. (Apr. 30, 2018), available at <https://www.cards.commerce.state.mn.us/CARDS/security/search.do?documentId={E05B9D66-0000-CF21-B9C1-9C254C0E73FC}> ("We (or a third party) may assume the management of your Restaurant . . . if you abandon or fail to actively operate your Restaurant..").

<sup>3</sup> Karen Marchiano, Glen Plattner and Leonard Vines, *Roadmap for the Default and Termination Process*, ABA 35<sup>TH</sup> ANNUAL FORUM ON FRANCHISING, at 36 (October, 2012).

<sup>4</sup> Kumon North America, Inc. ("Kumon") 2017 Franchise Disclosure Document, Attachment 2 – Franchise Agreement, §§ 10.5, 17.10, available at <https://www.cards.commerce.state.mn.us/CARDS/security/search.do?documentId={161E47BA-AE57-4593-85C3-CFD6B4DDA176}>. Kumon expressly requires in its Franchise Agreement that a separate Management Agreement be entered into between the parties if the franchisor assumes operation. See *id.*

<sup>5</sup> *Id.*

franchisors often explore other alternatives before exercising a right to terminate, depending on the severity and curability of the default and the specific circumstances. A franchisee faced with the possibility of a looming termination as a result of a default will undoubtedly choose to enter into a management agreement with the franchisor to handover operations rather than lose the franchised business. In these circumstances, franchisors will inevitably have more leverage in taking over management of a franchisee's location pursuant to a management agreement with favorable terms, such that a franchisor could step-in, even where a franchise agreement is silent.

In addition, where a franchisee needs to improve performance, requires extraordinary assistance, or is under financial distress, a franchisor may decide to step-in for a limited period of time pursuant to the mutual agreement of the parties.<sup>6</sup> In such cases, the management by the franchisor should be for a defined, interim period and should be designed with an eye towards either a sale of the franchise or a turnaround of the business.<sup>7</sup> Where the franchisor does not want to buy back the business, and there is no other franchisee to purchase the franchise, assuming operations during an interim period can serve as a viable solution for the franchisor to preserve the outlet for a future sale.

## **B. Considerations and Mechanisms**

Where a franchisor intends to exercise its step-in right during the term of a franchise, the franchisor and franchisee should consider the following questions:

- What is the ultimate objective?
- Are there any alternatives?<sup>8</sup>
- Who will comprise the management team?
- Is the franchisor ready and able to takeover?
- How will costs be covered?
- Who will bear the risks involved in the operation of the business?
- How long will the interim management period last?
- Will the franchisee have any involvement?

The parties should also consider whether having the franchisor stepping in violates any applicable Small Business Administration loan covenants or other agreements between a franchisee's lender and a franchisee. Because a blanket step-in right would violate the SBA's covenants, any interim management should be for a short period of time

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<sup>6</sup> See Jason B. Binford, Robert F. Salkowski, Andra Terrell, *Structured Workouts: Franchisor Strategies for Dealing with the Financially-Challenged Franchisee*, ABA 38TH FORUM ON FRANCHISING, at 7 (2015).

<sup>7</sup> Les Wharton and Sharon M. Lewonski, *Working with Financially Distressed Franchisees*, 31 FRANCHISE L.J. 2, 66, 68 (Fall 2011).

<sup>8</sup> See *generally id.* at 66-75 (analyzing alternatives to terminating a financially distressed franchisee, including lending money to the franchisee; offering royalty abatement, reduction or forgiveness; entering into a consulting arrangement to provide focused business consulting; or selling the outlet).

(i.e. in 90 to 120 day increments, but not exceeding 12 months).<sup>9</sup> Alternatively, the franchisor may consider only assuming limited aspects of the business to alleviate third party concerns.<sup>10</sup>

*i. Contractual Right Under Franchise Agreement*

Most franchise agreements include some form of contractual step-in right. These provisions should, at minimum, state: (1) the circumstances triggering the right; (2) the length of time the franchisor (or appointed manager) has the right to manage or assume operations of the franchised business; (3) whether and to what extent the franchisor is entitled to any additional compensation, usually in the form of a management fee; (4) how the parties will cover and track revenues and expenses; and (5) the scope of the franchisor's duty and liability. By having these express provisions in the franchise agreement, a franchisor's step-in right is self-executing, as the parties have already agreed to these provisions. Consequently, upon an event giving rise to an immediate need to step in to protect the brand or to ensure the continuation of a profitable location, the franchisor is able to exercise the step-in right without an independent agreement. However, as explained below, notwithstanding the existence of a contractual step-in right in a franchise agreement, it is generally still recommended that a separate management agreement or similar agreement be executed between the franchisee and the franchisor (or affiliate or third-party appointed manager) to detail the relationship between the parties and to take into account the unique concerns and circumstances at hand.

*ii. Management Agreement*

If a franchisor assumes operations and management of a franchisee's location (either pursuant to a franchise agreement's express provisions or as a result of a mutual decision between the parties), a management agreement should be prepared to authorize the franchisor to operate the franchised business on behalf of the franchisee and to delineate the parties' rights and obligations. While many franchise agreements contain express language governing a franchisor's right to step in to take over management or operations of the franchised business, the parties should still enter into a separate management or other agreement between the franchisee and franchisor (or most often, an affiliate) to separate the manager/owner relationship from the franchisor/franchisee relationship.<sup>11</sup> While many franchise agreements govern a franchisor's in-term step-in rights to some degree and anticipate that the parties will enter into a management agreement at the appropriate time, very few franchisors include a default form of a management agreement as part of their standard franchise disclosure document, given that a franchise relationship generally requires the franchisee to own and operate the

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<sup>9</sup> Dennis Wieczorek, *Franchise Agreement Provisions That Affect Eligibility for SBA Loans*, THE FRANCHISE LAWYER, Vol. 15, No. 2, Spring 2012, p.1.

<sup>10</sup> Binford, *supra* note 6.

<sup>11</sup> Nancy G. Gourley and David W Koch, *The Other Contracts in the Franchise Relationship*, ABA 29TH ANNUAL FORUM ON FRANCHISING, at 13 (Oct. 2006).

franchise.<sup>12,13</sup> Furthermore, the need for a franchisor to assume a franchisee's operations is merely hypothetical at the time when a franchisee receives a franchise disclosure document, and the facts giving rise to the need may be highly dependent on the franchisee's particular circumstances.

Where a franchisor/manager and franchisee enter into a management agreement, the parties should ensure that the following terms are addressed and contained in the agreement:

- **Term.** Since in-term management agreements are temporary, the management agreement should be for a limited period of time, with optional renewal terms, if any. Indeed, long-term management agreements in franchising are not typical, apart from industry-specific management agreements in hotel brands. The term of the management agreement should likewise be commensurate with the circumstances and the purpose. If the ultimate objective of entering into a management agreement is to turnaround the business with the expectation that the franchisee will eventually assume management, then the franchisee should attempt to negotiate a right to terminate the agreement prior to expiration. Obviously, such right should be subject to the franchisee meeting certain conditions or criteria and the franchisor being satisfied that the franchisee is able and competent to independently operate the franchised business.
- **Default, Termination.** The management agreement should cover how a termination would affect the franchise agreement, and vice versa. The parties should review the franchise agreement to determine whether there are any general cross-default provisions that would otherwise apply. In addition, the parties should consider the consequences of termination, including what happens to the location if the objective is not achieved and what kind of post-termination rights the franchisor has over the location.<sup>14</sup>
- **Compensation.** The management agreement should expressly state how the franchisor/manager is to be compensated, with such compensation being in addition to the royalty fees and other fees due under the franchise agreement.

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<sup>12</sup> Moreover, one court has suggested that where a franchisor simultaneously markets its franchise agreement with a management agreement giving the franchisor exclusive, indefinite control over a franchisee's business, the relationship may risk transforming from a traditional franchise to an investment contract governed by securities laws. See *Creative American Education, LLC v. The Learning Experience Systems, LLC*, No. 9:14-cv-80900, 2015 WL 2218847, at \*13-14 (S.D. Fla. May 11, 2015).

<sup>13</sup> In researching franchise systems that incorporated a default management agreement as part of the contracts attached to a franchise disclosure document, the authors were able to locate a "Salon Management Services Agreement," offered as a voluntary agreement by Ultimate Franchises, Inc. d/b/a 18|8 Fine Men's Salon®, pursuant to which a franchisee can opt to have an affiliate of the franchisor manage and supervise the operation of the salon for periods of 180 days. See Ultimate Franchises, Inc. Franchise Disclosure Document, Exhibit K – Salon Management Services Agreement (Jul. 12, 2017), available at <http://www.unhappyfranchisee.com/wp-content/uploads/2018/06/Eighteen-Eight-FDD-2017-CA.pdf>.

<sup>14</sup> See Wharton, *supra* note 7.

- **Costs and Expenditures.** Because there will necessarily be costs involved with the interim management of the franchised business, the management agreement must also expressly address how costs will be covered, including amounts and methods. Generally, the franchisee will be the party responsible for bearing the costs. These charges can take several forms. For example, the franchisor may pay costs out of the profits of the business during the applicable period. Alternatively, where the objective is to sell the franchised business, a franchisor may agree to pay the costs out of the proceeds of an ultimate sale.<sup>15</sup> In some instances, a franchisor and franchisee may have shared authority and access over the franchisee's bank account, while in other circumstances, a franchisor may decide to open a segregated bank account, over which it will have exclusive authority to withdraw funds to cover expenses. The parties should likewise consider what will happen if the business does not generate sufficient revenue to cover expenses. In most cases, the franchisor will require that the franchisee cover any shortfalls within a prescribed period of time or may require that a minimum amount of working capital be available. Franchisees, on the other hand, should attempt to ensure that they have the right approve certain expenditures over a specific amount or limit the franchisor's power to pay expenses to "day-to-day expenses" that are "standard" or "typical" to perform the manager's role in operating the franchised business.
- **Reporting.** From the franchisor's perspective, a franchisee must allow the franchisor or its appointed manager to perform its duties without interference from the franchisee, and the management agreement should include language to that effect. However, a franchisee will inevitably want some level of communication from the franchisor regarding the performance of the business. A management agreement should delineate what type of updating or reporting will be required by the franchisor, if any, and at what level of frequency. The franchisor should further require that the franchisee expressly agree to provide the franchisor with access to any necessary files, databases, computer systems, or other information in order to perform under the management agreement.
- **Employment.** Due to concerns of joint-employer liability, a franchisor entering into a management agreement will generally include a provision detailing the parties' respective responsibilities as they relate to employment matters. Where the employees of the franchisee will continue to work at the location, the franchisor will be hiring and/or managing the staff on the franchisee's behalf. In such circumstances, it is imperative to clarify whether staff will remain employees of the franchisee and who will be responsible for employment arrangements and liability with respect thereto. However, depending on the reason for the franchisor's decision to take over the operation of the franchised business, it may also feel that it is necessary to exercise control over the hiring and firing of the franchisee's staff.

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<sup>15</sup> *Id.*

- **Staffing:** At a minimum, to operate the franchisee's business for any period of time, the franchisor must have the ability to place at least one person in a management position to oversee day-to-day operations. The management agreement should expressly state the franchisor's obligation as it applies to how many representatives will be on-site.
- **Allocation of Responsibility:** If the franchisor will be responsible for taking over all day-to-day decision making responsibilities, the management agreement should be clear on this point and reiterate that the responsibilities are being delegated in accordance with the franchisee's operating agreement or bylaws. If the franchisor will only be taking over a portion of the responsibilities for operating the business and the franchisee will retain some rights, the management agreement should be clear on which rights the franchisee will retain and how disputes about the extent of each parties' rights will be resolved.
- **Insurance.** Before entering into any management agreement and taking over the operation of a franchisee's business for any length of time, a franchisor should closely scrutinize the insurance it and the franchisee hold to determine whether the existing coverage is sufficient to protect the franchisor from any claims against it arising out of the franchisor's operations. If it is not, the franchisor should obtain the necessary coverage and provide that the cost of that coverage be borne by the franchisee.
- **Scope; Appointment.** Given that the franchisor will be assuming management and operation of the franchised business on behalf of the franchisee, it is imperative that the management agreement define the scope of the manager's duties and the parties' relationship, with the manager having limited agency and acting as an independent contractor. Without clear and express language, an unintended agency or fiduciary duty may arise.<sup>16</sup>
- **No Waiver of Default.** If the franchisor is exercising step-in rights in lieu of termination, any management agreement should include an anti-waiver provision providing that any forbearance does not constitute a waiver of future enforcement rights under the franchise agreement. Such a clause is designed to protect against an argument by the franchisee that the franchisor has elected its remedy for any default and, therefore, waived its right to terminate.

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<sup>16</sup> See, e.g. *Ivesdal v. Three Rivers Hospitality, LLC*, No. 1:12-cv-073, 2014 WL 12543858 (D.N.D. Feb. 7, 2014). In *Ivesdal*, the plaintiff hotel owner engaged a third party manager to manage operations of a franchised AmericInn hotel pursuant to a management agreement. *Id.* at \*1. Following several years of operations, the hotel owner sued for, amongst other things, breach of fiduciary duty, claiming that the manager mismanaged the hotel and cause significant damages. *Id.* On summary judgment, the court found that the language of the management agreement did not support a separate and distinct fiduciary relationship, given that the manager's representation was expressly limited to the scope of authority granted in the contract itself, which explicitly disclaimed the existence of a principal/agent relationship. *Id.* at \*3. Therefore, the manager was not the hotel owner's agent and did not owe a fiduciary duty. *Id.* at \*4.

- **Release, Limitation of Liability.** Whatever the triggering event for the franchisor's exercise of its right to step-in and operate the franchisee's business, it is an opportunity for the franchisor to limit its potential liability for claims that may have arisen to that point in the relationship by obtaining a release of claims by the franchisee, , especially where the management agreement is executed in lieu of termination. In such circumstances, the management agreement should have an agreement from the franchisee to indemnify, release, and hold harmless the franchisor and/or manager from any and all existing claims arising under or relating to the franchise agreement, the management agreement, or the franchised business. In addition, the management agreement should contain an exculpatory clause requiring the franchisee to indemnify and hold harmless the franchisor and/or manager for all damages arising from any cause other than fraud, gross negligence or intentional conduct. Consequently, the franchisor is able to reduce the risk of the franchisee being able to successfully blame the franchisor if the management does not yield successful results, so long as the franchisor is performing pursuant to reasonable, good-faith efforts.
- **Indemnification:** Just as the franchisor should ensure that insurance is in place to properly protect it from any losses arising out of its operations of the franchisee's business, it should also provide that the franchisee will be responsible for any losses actually incurred. The franchisor may also wish to obtain guarantees from the franchisees principals to support this obligation.
- **Miscellaneous.** When preparing the management agreement, the parties should ensure that the governing law, venue, dispute resolution and enforcement provisions are consistent with those contained in the franchise agreement. While a management agreement can arguably fall within the scope of these provisions contained in the franchise agreement, it is best to expressly set forth the intended, applicable provisions in writing to eliminate any arguments to the contrary.<sup>17</sup>

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<sup>17</sup> See *Tennsonita (Memphis), Inc. v. Cucos, Inc.* 1991 WL 66993, at \*3 (Tenn. App. May 2, 1991) (forum selection clause contained in franchise and development agreement applying to "any dispute arising out of or in connection with the franchisor-franchisee relationship" encompassed oral takeover agreement, given that it was franchisee's failure to meet development schedule which, in part, led to the oral takeover agreement; franchisee's motion to dismiss denied).

iii. Ancillary Documentation

The nature of the franchised business and the structure of the franchisee may suggest the need for additional documentation. For example, the franchisor may be advised to obtain a power of attorney in order to demonstrate to a third party's satisfaction that it has authority to act on the franchisee's behalf.<sup>18</sup>

**C. Claims Associated with a Franchisor Stepping-In**

i. Mismanagement and Breach of Fiduciary Duty

Where a franchisor decides to assume operations of a franchisee's business, the franchisor's actions are generally designed to improve, stabilize or gain control over the franchised business. On the other hand, franchisees may not want a franchisor to step-in and run their business due to increased costs, loss of control, and potential damage to the franchisee's operation.<sup>19</sup> Indeed, if the franchised business declines after a franchisor assumes operations and management, who is responsible?

In *Creative American Education, LLC v. The Learning Experience Systems, LLC*,<sup>20</sup> the plaintiff franchisee ("CAE") purchased two "The Learning Experience" franchised centers as the basis for CAE's owners to obtain EB-5 investor visas to immigrate to the United States.<sup>21</sup> However, the owners, who were residents of Singapore, were unable to obtain the visas as expected.<sup>22</sup> To ensure the timely buildout and opening of the franchises, the parties entered into a management agreement and power of attorney giving the franchisor ("TLE") the right to exclusively manage the centers on behalf of CAE.<sup>23</sup> Pursuant to the management agreement, TLE would manage the centers for a period of one year, and then the parties would co-manage the centers for at least six months thereafter to allow for a smooth transition.<sup>24</sup> TLE opened and operated the centers for a period of time, but when CAE began to assume management responsibility, problems arose, including various health and safety violations.<sup>25</sup> As a result, TLE informed CAE of its immediate intent to step back in to assume exclusive control of the centers and demanded additional monies from CAE.<sup>26</sup> In response, CAE filed suit against TLE for, amongst other things, breach of the management agreement, breach of fiduciary duty under the power of attorney, fraudulent and negligent misrepresentation, violations

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<sup>18</sup> Some examples include: (a) to access or control the franchisee's bank accounts, (b) to communicate with various government agencies, or (c) to submit claims to the franchisee's insurance carrier.

<sup>19</sup> Binford, *supra* note 6.

<sup>20</sup> 2015 WL 2218847 (S.D. Fla. May 11, 2015) ("*Creative American I*").

<sup>21</sup> *Id.* at \*1.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.* at \*2.

<sup>24</sup> *Creative American Education, LLC v. The Learning Experience Systems, LLC*, 2015 WL 4655087, at \*2 (S.D. Fla. July 31, 2015) ("*Creative American II*").

<sup>25</sup> *Id.* at \*3.

<sup>26</sup> *Id.* at \*4.

of federal and state securities laws, and violations of Florida's Deceptive and Unfair Trade Practices Act ("FDUTPA").<sup>27</sup> In granting summary judgment in TLE's favor on CAE's claims of misrepresentation, the court held that the merger and integration, and release provisions contained in the franchise and management agreements precluded CAE from bringing such claims.<sup>28</sup> However, the court declined to find that CAE's allegations regarding TLE's deceptive management and performance under the management agreement were not actionable under FDUTPA, and therefore denied summary judgment as to the FDUTPA claim.<sup>29</sup>

While TLE ultimately prevailed on all counts following a bench trial, the district court's analysis on summary judgment of the claims relating to securities violations and power of attorney claim is instructive. Namely, CAE alleged that the sale of a franchise combined with the management agreement "effectively gave total control of the franchise to TLE, thereby transforming the sale of the franchise into an investment with profits to come solely from the efforts of TLE."<sup>30</sup> However, because the management agreement was a voluntary transaction that was entered into as part of a separate and distinct contract as a "unique accommodation," the court found that there was no "investment contract," under the Securities Act of 1933.<sup>31</sup> Moreover, the parties intended for CAE to manage the franchises, and CAE ultimately participated in the management.<sup>32</sup> On the other hand, had TLE simultaneously marketed its franchise agreement and management agreement to CAE as interdependent agreements requiring TLE assume exclusive, indefinite control of the franchise, the outcome would have certainly been different.<sup>33</sup>

While certain actions of TLE may have been consistent with the powers granted by the management agreement, the power of attorney expressly conferred on TLE broader duties "to act generally in relation to all matters of every kind in which [TLE] may be interested or concerned with respect to the operation and management of the franchise."<sup>34</sup> As a result, the power of attorney conferred additional statutory fiduciary duties by virtue of Fla. Stat. § 709.2114(1),<sup>35</sup> and the district court declined to grant

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<sup>27</sup> *Creative American I*, 2015 WL 2218847 at \*3.

<sup>28</sup> *Id.* at \*10.

<sup>29</sup> *Id.* at \*12.

<sup>30</sup> *Id.* at \*13.

<sup>31</sup> *Id.*

<sup>32</sup> *Creative American I*, 2015 WL 2218847 *Id.* at \*16.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* at \*17.

<sup>35</sup> The Florida statute governing powers of attorney provides:

- (1) An agent is a fiduciary. Notwithstanding the provisions in the power of attorney, an agent who has accepted appointment:
  - (a) Must act only within the scope of authority granted in the power of attorney. In exercising that authority, the agent:
    1. May not act contrary to the principal's reasonable expectations actually known by the agent;
    2. Must act in good faith;
    3. May not act in a manner that is contrary to the principal's best interest, . . . .

Fla. Stat. § 709.2114(1).

summary judgment in TLE's favor on the power of attorney claim.<sup>36</sup> Franchisors should therefore be cautious in drafting management agreements and other related agreements so as not to create unintended fiduciary duties, where such duties would not otherwise exist between a franchisor and franchisee.

ii. Lessor Claims Concerning Assumption of Lease

Ultimately, a franchisor should only exercise its step-in right if it is ready to do so and has the tools and resources necessary to achieve its objectives. *Westport 85 Ltd. Partnership v. Casto*,<sup>37</sup> demonstrates the type of exposure faced by a franchisor if it is not properly prepared to assume a franchisee's lease when it exercises its right to step in. In *Casto*, the franchisee entered into a lease rider with the franchisor and the lessor. The rider provided that all right, title and interest in the lease agreement would be assigned to the franchisor upon the happening of two conditions: (1) the termination of the franchise agreement; and (2) the franchisor's exercise of its option to assume the lease within 30 days after termination.<sup>38</sup> Three years into the term of the franchise agreement, the franchisee entered into a form of management agreement provided by the franchisor.<sup>39</sup> Under the management agreement, a prospective buyer of the franchise ("Trapp") was to manage the business until the eventual sale of the business to Trapp.<sup>40</sup> The franchisor provided the required disclosures to Trapp and also collected franchise fees.<sup>41</sup> When the franchisee defaulted under the franchise agreement, the franchisor terminated the franchise and notified the lessor of its intent to assume the lease.<sup>42</sup> Pursuant to a settlement agreement, Trapp left the premises, and the franchisor attempted to locate a replacement operator to manage the location pursuant to a new management agreement.<sup>43</sup> However, when the franchisor was unable to do so, the lessor sued the franchisee and the franchisor for breach of the lease agreement.<sup>44</sup> The franchisor cross-claimed against the franchisee for breach of the franchise agreement.<sup>45</sup> In affirming the lower court's award of damages to the lessor and the dismissal of the franchisor's counter-claim, the court held that the management agreement entered into between the franchisee and Trapp constituted a novation and substitution of contract with respect to the franchise agreement and therefore terminated the franchise agreement between the franchisor and franchisee.<sup>46</sup>

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<sup>36</sup> *Id.*

<sup>37</sup> 450 S.E.2d 505 (N.C. App.1994).

<sup>38</sup> *Id.* at 507.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.* at 510.

<sup>41</sup> *Id.*

<sup>42</sup> *Casto*, 450 S.E.2d at 507.

<sup>43</sup> *Id.* at 507-08.

<sup>44</sup> *Id.* at 508.

<sup>45</sup> *Id.*

<sup>46</sup> *Id.* at 510.

iii. Other Potential Claims

In addition to the foregoing, step-in rights can create liability against the franchisor for other miscellaneous claims, including those relating to claims for maintenance of the property, vicarious liability, joint employer liability, claims for defects and other issues occurring on the premises. While the case law is sparse on these types of claims, franchisors should be cautious to reduce such risk by ensuring that adequate insurance coverage is obtained and addressing potential exposure by crafting detailed contractual provisions to account for any unique circumstances.<sup>47</sup>

iv. Step-in Right as a Defense to Injunctive Relief

If there is a pending dispute between a franchisee and franchisor regarding the legality of an attempted termination, the parties should also consider how a franchisor's decision to exercise its contractual step-in rights may play into litigation strategy. Indeed, a franchisor's intent to assume a franchisee's business may ultimately defeat a franchisee's motion for preliminary injunctive relief seeking to enjoin a termination. Specifically, in *Sunni, LLC v. Edible Arrangements, LLC*,<sup>48</sup> following the franchisor's refusal to renew the franchisee's three franchise agreements based on the franchisee entering into a guilty plea for tax fraud, the franchisee attempted to sell his franchised businesses.<sup>49</sup> When the franchisor refused to allow the sale, the franchisee initiated arbitration.<sup>50</sup> Before the arbitrator rendered a decision, however, the franchisor informed the franchisee that it intended to terminate the franchisee's access to the franchisor's online ordering system, and the franchisee filed an action seeking injunctive relief to enjoin the franchisor's efforts to terminate pending completion of the arbitration.<sup>51</sup> However, since the franchisor informed the court that it intended to assume management of the franchises, the franchisee was unable to show irreparable harm to enjoin the termination.<sup>52</sup> The Southern District of New York reasoned that since the stores would not close or lose their leases, employees would remain employed, and the franchisor would keep track of any profits earned and repay them to the franchisee should the franchisee succeed in arbitration.<sup>53</sup> Accordingly, the franchisee could not demonstrate that it would suffer irreparable harm necessary to warrant injunctive relief.<sup>54</sup>

#### **D. Disclosure Requirements**

To the extent that the franchisor intends to provide a contractual right for itself to step in and operate the franchise during the term of the agreement, the FTC Franchise

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<sup>47</sup> See Section II.B.ii, *supra*.

<sup>48</sup> No. 14 civ. 461 (KPF), 2014 WL 1226210 (S.D.N.Y. Mar. 25, 2014).

<sup>49</sup> *Id.* at \*4.

<sup>50</sup> *Id.* at \*5.

<sup>51</sup> *Id.*

<sup>52</sup> *Id.* at \*9.

<sup>53</sup> *Sunni*, 2014 WL 1226210, at \*9.

<sup>54</sup> *Id.*

Rule<sup>55</sup> and the NASAA 2008 Franchise Registration and Disclosure Guidelines (the “NASAA Guidelines”)<sup>56</sup> require that the prospective franchisee be provided with disclosure of those arrangements in a franchise disclosure document.<sup>57</sup> The form and substance of those disclosures will vary depending on the nature and effect of the provisions.

Where franchisors retain the right to step-in and operate the franchised business in the event of the death or disability of the franchisee or its principal, the NASAA Guidelines indicate that the franchisor should “describe briefly” this provision in a chart in Item 17, under the heading “p. Death or disability of franchisee.”<sup>58</sup>

Similarly, if a franchisor reserves a right to take over operations of a franchisee as the result of a default, the chart in Item 17 should include a reference to and summary of the provision. But, where the disclosure is placed may depend on the purpose of the provision. For example, if the step in right is merely an intermediate step toward an eventual termination of the franchise agreement – perhaps to provide for operation of the business during a required notice period, rather than allow (in the franchisor’s view) an incompetent franchisee to further damage the brand – then it should be disclosed in the Item 17 chart under the heading “h. ‘Cause’ defined – non-curable defaults.”<sup>59</sup> But, there may be circumstances in which the franchisee’s default, while serious, is capable of being remedied and the franchisee is otherwise an asset to the system. For example, the franchisee may have suffered a life event that, while not approaching a “death or disability”, is nonetheless significant enough to have a serious, and temporary, impact on the franchisee’s ability to run the business.<sup>60</sup> As a practical matter, franchisors typically address those sorts of circumstances on an *ad hoc* basis and negotiate a temporary management agreement in these types of circumstances, but it is conceivable that they could provide the mechanism to address them in the franchise agreement. And, if they do, the chart in Item 17 should include a reference to and summary of the provision under the heading “g. ‘Cause’ defined – curable defaults.”<sup>61</sup>

Because the chart in Item 17 is intended to provide cross-references to the applicable provisions of the franchise agreement and the NASAA Guidelines call for providing a brief description under a heading entitled “Summary”, a franchisor certainly does not have an obligation to provide an exhaustive exposition of the terms of such a

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<sup>55</sup> 16 C.F.R. § 436, 437 (2007).

<sup>56</sup> North American Securities Administrators Association, Inc (“NASAA”) 2008 Franchise Registration and Disclosure Guidelines (Jul. 1, 2008), <http://www.nasaa.org/wp-content/uploads/2011/08/6-2008UFOC.pdf> [hereinafter “NASAA Guidelines”].

<sup>57</sup> *Id.* at 67 (discussing Item 22).

<sup>58</sup> *Id.* at 55-56.

<sup>59</sup> *Id.*

<sup>60</sup> Examples might include: (a) the death of a spouse or a child, (b) the franchisee being called to active military duty, or (c) the franchisee suffering emotional issues (short of disability) as a result of domestic violence, assault or other incident.

<sup>61</sup> NASAA Guidelines, *supra* note 56, at 55-56.

provision in that Item. Merely identifying that the provision exists, providing an accurate cross-reference and a general description of the provision is enough.

But, depending on the terms of the provision providing the step-in rights, other disclosure obligations may exist. For example:

- If the provision provides for compensation to the franchisor for operating the franchised business, those payments must be disclosed in Item 6.<sup>62</sup>
- If the franchisor is obligated to step-in under particular circumstances, that must be disclosed in Item 11 as a form of assistance “during the operation of the franchise.”<sup>63</sup>
- Since the franchisor’s step-in rights may be seen as “soliciting or accepting orders from customer’s inside the franchisee’s territory” – even if done on the franchisee’s behalf – those rights must be disclosed in Item 12.<sup>64</sup>
- In any Item 19 financial performance representation, some additional disclosure will be required. “Managed outlets” may be included in a financial performance representation as a company-owned outlet, as a franchisee outlet or as a separate category. But, if the results of the managed outlet is materially different from the results of other outlets, they may not be included in the financial performance representation.<sup>65</sup>
- Since a franchised unit that is operated by the franchisor under a temporary step-in right is still owned by the franchisee, Item 20 should continue to treat the unit as a franchised outlet, but the FTC’s Compliance Guide encourage the use of footnotes to clarify situations that make the status of

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<sup>62</sup> *Id.* at 38-39.

<sup>63</sup> *Id.* at 45-46.

<sup>64</sup> *Id.* at 49-50. Note that disclosure may also be required under Item 12((l)(5)(ii)(A) which requires disclosure of “[w]hether continuation of territorial exclusivity depends on achieving a certain sales volume, market penetration or other contingency, and the circumstances when the franchisee’s territory may be altered.” *Id.* at 50. As the title of the disclosure item suggests, this requirement appears to be concerned primarily with potential elimination or modification of the franchisee’s exclusive territory. And, if the franchisee’s territory will not be modified or eliminated in connection with the exercise of the step-in rights, there is a reasonable argument that disclosure of the step-in rights under this clause is unnecessary. But, the same disclosure requirement also indicates “[s]tate the franchisor’s rights if the franchisee fails to meet the requirements.” *Id.* It is not clear whether this requirement to describe the franchisor’s rights is limited to circumstances where the franchisee’s territory may be altered. This is, however, something of an academic exercise, because disclosure of the step-in rights will be required under clause 12((l)(6)(i) in any event.

<sup>65</sup> NASAA Franchise Commentary, Financial Performance Representations, <https://www.nasaa.org/wp-content/uploads/2017/05/Financial-Performance-Representation-Commentary.pdf>, at commentary 19.7 (May 8, 2017).

a particular unit unclear.<sup>66</sup> But, in order to reduce any possibility for confusion for prospective franchisees, a franchisor should clearly identify those units that were being operated by the franchisor on the franchisee's behalf.

As noted above in the discussion of *Creative American* and because the authors' experience suggests that the practice of proposing a standard form of Management Agreement as part of the franchise offering is relatively rare, most franchisors should not be required to include a copy of it in the FDD in Item 22. But, if a franchisor intends to include a form of Management Agreement as part of the franchisor offering – and therefore, include a copy of it in Item 22 – additional disclosure obligations may exist.<sup>67</sup> For example, the charts in Item 9 and Item 17 may need to include references to specific provisions of the Management Agreement, where applicable.

### **E. Practice Tips**

In addition to ensuring that the applicable franchise agreement,<sup>68</sup> management agreement, and other agreements are carefully drafted, franchisors may be able to reduce the need to exercise step-in rights by ensuring that franchisees are properly vetted and qualified prior to granting a franchise. Indeed, in many cases, franchisors decide to exercise step-in rights in circumstances where the franchisee is not financially stable or is ill-equipped to independently manage the franchised business. Moreover, a franchisor should appropriately weigh the relevant options, risks, and alternatives before committing to assuming operations and management of a franchisee's location. Such alternatives may include providing financial relief to a troubled franchisee in the form of royalty abatement or deferral, providing additional training or assistance in lieu of assuming operations, or exercising termination rights in cases where assuming operations or purchasing the franchised outlet is not feasible.

Franchisees, on the other hand, may be able to avoid the trigger of a franchisor's step-in rights, or limit such rights, by attempting to negotiate with the franchisor regarding the time period of interim management, caps on management fees, or the removal depending on the circumstances and bargaining power involved.<sup>69</sup> Moreover, if a franchisee has made arrangements ahead of time by having a formal succession plan or business interruption plan in place, a franchisee may be able to avoid a franchisor from stepping in altogether.

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<sup>66</sup> Federal Trade Commission, *Franchise Rule Compliance Guide*, at 97 (May 2008), <http://www.business.ftc.gov/documents/bus70-franchise-rule-compliance-guide>.

<sup>67</sup> See NASAA Guidelines, *supra* note 56, at 67 ("Item 22: Contracts. Attach a copy of all proposed agreements regarding the franchise offering.").

<sup>68</sup> See Appendix I for a list of sample franchise agreement provisions.

<sup>69</sup> Binford, *supra*, note 6.

### III. IN-TERM PURCHASE RIGHTS

There may be situations in which a franchisor wishes to retain the right to buy a franchisee's business during the term of the franchise agreement even if the franchisee is not in default. Generally, these rights fall into two categories: (1) the franchisor's preemptive rights to buy the franchisee's business, rather than let the franchisee transfer it to a third-party, or (2) the franchisor's right to purchase the franchisee's business following a triggering event.

#### A. Preemptive Rights

Where a franchisee seeks to sell its business<sup>70</sup> to a third party, franchisors often wish to have the ability to step in to buy the business instead. Typically, the franchisor provides a right of first refusal (ROFR) for itself, under which it can buy the franchisee's business on the terms offered to the franchisee by a third-party. ROFRs are common contract terms in many types of sales. The general concept, issues and concerns that exist with ROFRs in other situations also apply to the sale of franchised businesses.

ROFRs usually work as follows: (a) the ROFR is triggered by a bona fide offer from a third-party to buy the business; (b) the franchisee must provide the franchisor with notice of the bona fide offer; and (c) the franchisor will have period of time to evaluate the terms of the offer and determine whether or not to exercise the ROFR.

For an offer to be "bona fide" it must be made in good faith and be capable of being accepted as a binding contract. To be made "in good faith", at a minimum, the offeror must intend to actually purchase the business if the offer is accepted. Contractual ambiguity can lead to different interpretations and disputes, so both franchisor and franchisee are best served by ROFR provisions that clearly set the parameters of the triggering and execution of the franchisor's ROFR. Some specific areas of potential dispute that can be addressed with careful drafting include:

- Does a transfer by gift or inheritance constitute an offer that will trigger the franchisor's ROFR?
  - If so, how do the parties value such a transfer in order to determine what the purchase price to the franchisor will be?
- Does an offer that includes an offer to purchase property that is not an asset of the franchised business constitute an offer that will trigger the franchisor's ROFR?

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<sup>70</sup> For the purposes of this discussion, we assume that "the business" includes the assets and the franchisee's rights and obligations under the franchise agreement. See *Country Inn & Suites By Carlson, Inc. v. Interstate Properties, LLC*, No. 08-16850, 2009 WL 1298401 (11th Cir. May 12, 2009) (holding that a sale of a hotel to a purchaser who declined to accept the transfer of the License Agreement with the franchisor was a default under the transfer provisions of the License Agreement).

- If so, how do the parties value that property?
- Can the franchisor decline to purchase that property and still exercise its ROFR to purchase the franchised business?
- If the offer includes the transfer of property or other non-monetary terms as a form of consideration, how (if at all) may the franchisor exercise its ROFR? May the franchisor substitute cash?
  - If so, how will that property be valued?
- If the offer includes payment terms or other obligations,<sup>71</sup> must the franchisor match those terms or can the franchisor's exercise of its ROFR deviate from those terms?
- What notice must the franchisee provide to the franchisor?
  - What must the notice include?
  - How long will the franchisor have to exercise its ROFR?
  - If the terms of the original offer change, does the franchisee have to provide a new notice and additional time for the franchisor to review?
    - If so, is this true of all changes to the offer, or only "material" changes?
    - Does a change in the closing date constitute a "material" change?
- If the offer is a "package deal" – involving multiple franchised business – may the franchisor elect to exercise or not exercise its ROFR on a franchised business by franchised business basis, or must it take all of the businesses included in the offer?
  - If it may exclude one or more franchised business from its exercise of its ROFR, how will the purchase price be adjusted to account for the exclusion?

One of the principal positive attributes of a ROFR is that, ostensibly, it allows the franchisee to determine if and when to sell its business – at a price determined by the market and not some predetermined calculation that may be intentionally skewed in a way to arrive at a sub-market price. But, traditional analysis of ROFRs assumes that the existence of the ROFR has a negative impact on the marketability of the franchised

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<sup>71</sup> Examples of "other obligations" might include an agreement to retain the franchisee as a paid consultant for a period of time, retain key employees, or take on accrued liabilities.

business and the ultimate sale price. This is because a potential third-party purchaser is expected to discount the value of the business to account for the possibility that the time, effort and money that they invest in doing their due diligence and preparing an offer will be lost if the franchisor exercises its right.

An alternative form of preemptive right that may be included in a franchise agreement instead of (or, conceivably, in addition to) a ROFR is a “right of first offer” (ROFO). Typically, a ROFO will require a franchisee who wishes to sell its business to first notify the franchisor and allow the franchisor the opportunity to buy the business on the terms at which the franchisee seeks to sell it. As with a ROFR, the franchisee determines when they are willing to sell and on what terms. Additionally, the franchisee may find a ROFO preferable to a ROFR because it (arguably) may not have a negative impact on the marketability of the franchised business to third parties. But, as with a ROFR, there are ample opportunities for drafting ambiguities to create different interpretations and disputes, many of which are essentially the same issues noted above regarding ROFRs. But, some particular concerns relating to ROFOs include:

- If the franchisor declines to purchase the business on the terms initially offered by the franchisee, may the franchisee then accept a third-party offer for less than the price offered to the franchisor? Or, must the franchisee first offer the franchisor the opportunity to buy the business on those terms as well?<sup>72</sup>
- If the franchisee presents an offer to the franchisor, and the franchisor declines to buy the business on those terms, is the franchisor’s ROFO extinguished forever? Does the franchisee have a limited time after the franchisor declines to buy the business within which to sell, after which the franchisee must again offer the business to the franchisor?

If the franchisor declines to exercise its preemptive right and the franchisee ultimately is able to sell its business to a third-party (which typically will include a release of claims by the transferor), the risks to the franchisor of these provisions is minimal. But, if a franchisor ultimately rejects the proposed transfer, the franchisor should be aware that the existence of a preemptive right may be used as a basis for a claim against the franchisor. For example, if a franchisor rejects a proposed transferee on the basis that the franchisee lacks sufficient resources to buy the business and properly capitalize it, the franchisee may claim that the rejection was merely a pretext to depress the purchase

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<sup>72</sup> A situation in which the franchisee must give the franchisor a chance to buy the business on the terms offered or to negotiate different terms, is sometimes called a “right of first negotiation.”

price of the business so that the franchisor could then exercise its preemptive rights on more favorable terms.<sup>73</sup>

## B. Options

A franchisor may have the desire to buy the franchisee's business at any time (i.e., not just at the time a franchisee wishes to sell, or upon termination or expiration of the franchise agreement). To provide for this, it may include an option to buy the franchisee's business in its franchise agreement. An unscientific sampling of FDDs available in state Internet databases and the authors' anecdotal experience suggests that these provisions are far less common than ROFRs, ROFOs and post-termination buyback rights.

Because franchisor options to buy the franchisee's business during the term of the franchise (in the absence of a default) are relatively rare, a franchisee (or a prospective franchisee or counsel) might fairly question whether they are merely a mechanism to allow the franchisor to take advantage of the franchisee's effort to develop the market and opportunistically buy the business using a valuation that will result in a windfall for the franchisor, in some circumstances. Put another way, a franchisee could interpret these provisions as a way for the franchisor to shift all of the risk to the franchisee while retaining the right to steal the upside from the franchisee.

The first and most obvious answer to this objection is that the terms of the option have to be agreeable to both parties when the franchise agreement is signed, and if the franchisee has concerns about the proper method of valuation, the franchisee can address these concerns before entering into the contract. While true, this still does not explain why the franchisor would need or want to include such a provision in the contract. Another answer might be that the franchisor has no interest in including a provision in its franchise agreement that would be so unfair to the franchisee that it might make selling the franchises more difficult. Again, while true, this does not effectively respond to the concern because it does not provide a plausible alternative explanation for why the franchisor would want to have an option to buy the franchisee's business during the term in the absence of a default or transfer.

One explanation might be that the franchisor may decide during the term to cease operating as a franchise system. Perhaps the franchisor will come to that decision because the economics of the market have reduced margins such that franchisees can no longer achieve a reasonable return and still pay sufficient royalties to compensate the franchisor for its support obligations. Maybe the franchisor will decide that it wants to exit the market entirely to focus on other aspects of its business. In either of these cases, an

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<sup>73</sup> See *Sherman v. Master Protection Corp.* No. H022748, 2002 WL 31854905 (6th Cir. Dec. 18, 2002) (holding that the franchisor discouraged buyers or blocked potential sales by withholding approval and imposing unreasonable financial requirements on prospective buyers in order to enable it to purchase the franchisee's business at a deflated price, as specified in the franchise agreement). See also *Breland v. McDonald's Corp.*, No. 1:09-cv-0523-BBM, 2009 WL 10666356 (N.D. Ga. Dec. 31, 2009) (holding that McDonald's may have violated the covenant of good faith and fair dealing by abusing its discretion to approve proposed sales for the purpose of repurchasing the franchise at "an unreasonably low price").

option provides the franchisor with the ability to respond to market forces in a way that provides a method of compensating the franchisee.

Another explanation may be that the franchisor may want to buy back franchised businesses in order to restructure the business model or facilitate a larger transaction. For example, if the franchisor wants to sell the system to a third party who does not want to operate it as a franchise system, the franchisor may want the ability to buy out the franchisee so that no single franchisee can “hold the deal hostage” by refusing to sell. Or, the franchisor may have designs on doing an initial public offering at a point in the future and believes that by having the ability to “roll up” the system into a single operating unit, they will be able to maximize the value of the business.

Whatever the franchisor’s rationale may be, the franchise agreement should be as clear as possible with regard to the terms of the option so that a prospective franchisee can make an informed decision about whether the provision creates an unacceptable risk and – to the extent possible – avoid disputes about the exercise of the option. Typically, the franchise agreement should address, at a minimum:

- Whether the option is predicated or conditioned on the occurrence of a “triggering event” or other prerequisite.
  - If so, whether the option is extinguished forever if the franchisor fails to exercise the option, or whether the option may be triggered multiple times during the term.
- What mechanism will be used to value the business – e.g., fair market value, book value, a multiple of EBITDA, etc.
- If the valuation requires exercise of some interpretation, who determines the value -- e.g., one appraiser appointed by the franchisor, two appraisers, three appraisers, etc.

### **C. Disclosure Requirements**

The principal disclosure obligations for any ROFR, ROFO or option are included in Item 17. In particular, the Item 17 chart should include a cross-reference to and a summary of any right of first refusal under the heading “n. Franchisor’s right of first refusal to acquire the franchisee’s business” and any option to purchase the franchisee’s business under the heading “o. Franchisor’s option to purchase franchisee’s business.”<sup>74</sup>

Item 9 of the NASAA Guidelines contains a cross-reference chart of significant provisions affecting the franchisee’s “principal obligations” that that is similar to the chart

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<sup>74</sup> NASAA Guidelines, *supra* note 56, at 55-56. Note that the NASAA Guidelines do not define what constitutes a right of first refusal or a right of first offer. But, because a right of first offer is so similar to a right of first refusal, the authors suggest that they should be treated as a right of first refusal for the purposes of disclosure.

contained in Item 17, but lacks a requirement to include any summary. While the NASAA Guidelines do not specifically list the franchisor's right of first refusal or option to purchase the business (and the franchisee's corresponding obligation to sell the business), the instructions indicate that the franchisor should "[i]nclude additional obligations, as warranted."<sup>75</sup> Given the potential impact of these rights, including a reference to them in Item 9 is advisable.

#### **IV. POST-TERM BUYBACKS AND TAKEOVERS**

##### **A. Under What Circumstances Can and Should Franchisor Exercise Buyback and Takeover Rights?**

What happens to the franchised business location at the end of the franchise relationship? Certainly, there are situations in which it is in the franchisor's best interest to simply let the business close and de-identify. But, in many cases, the franchisor will determine that the continued operation is best for the brand, the system, and its bottom line. With the end of the franchise relationship creating a void in the operation of the business, the franchisor is faced with a variety of decisions about how best to fill that void.

One option might be to re-sell the franchise to another franchisee who will have the benefit of taking over an existing business, rather than having to develop a new business from scratch.<sup>76</sup> Another option might be to take over the operation of the business directly or through an affiliate. The franchisor's decision will ultimately be informed by the situation. If the franchisor does not have an employee available who can step in and operate the business effectively without causing significant damage to other parts of the franchisor's business or the system, taking over the business directly or through an affiliate may not be a viable option. Similarly, if the franchisor does not have a qualified and willing third-party to step in a take over the business, re-selling the business may not be a viable option.

For either option to be meaningful, however, the franchisor must have a plan in place for how it will transition the franchised business to its control (or, ultimately, to another franchisee's control). After all, in most cases, the franchisee will own (or lease) the real estate and the assets used in the business. If the franchisor must find a new location for the franchised business, much of the goodwill of the existing business may be lost. And, if the franchisor must equip a new facility with new fixtures and equipment, it will likely face lengthy delays and higher costs than it would if it were able to simply take control over the assets used by the franchisee.

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<sup>75</sup> *Id.* at 42 (discussing Item 9: Franchisee's Obligations).

<sup>76</sup> Of course, taking over an existing business is not always easier than starting a new one. An existing business may be burdened with a poor location, a less than stellar local reputation among customers, and other limitations that may have led to the failure of the franchise and the termination of the franchise agreement. In those circumstances, franchisors do not typically have an incentive to keep the location operating. And, in the rare circumstances that they do – where closing the business would create severe damage to the brand, for example – the franchisor will likely have to heavily incentivize a new franchisee to take over the location in order to find someone qualified and willing to take it over.

## B. Mechanisms and Ancillary Agreements

### i. Conditional Lease Assignment

In franchise systems that involve retail locations – or, at least, that benefit from operating from a fixed location – having the ability to step in and take over a franchisee’s lease is often a critical element of maintaining the continuity of the business. Typically, a franchisor provides this ability for itself in an ancillary agreement to the franchise agreement, often called a “Conditional Lease Assignment.” The Conditional Lease Assignment generally requires the landlord to agree to allow the franchisor (or its designee) to elect to step into the franchisee’s shoes and assume its obligations under the lease, upon the occurrence of certain events – in particular, the termination or expiration of the franchise agreement (among others).

Often the lease assignment is part of a broader agreement with the franchisee’s landlord and the franchisee, which – in addition to providing for the franchisor to assume the franchisee’s rights under the lease – also obligates the landlord to:

- provide notice to the franchisor of franchisee defaults under the lease;
- give the franchisor an additional period in which to cure those defaults;
- permit the franchisor the ability to enter and occupy the premises; and
- allow the franchisor to assign the lease or sublet the premises to a third-party.

To the extent that the rights of only the franchisee and franchisor are involved, it is common to find provisions such as these in the franchise agreement itself or in an exhibit to the franchise agreement. But, because the landlord will ultimately need to be a party to any agreement binding it to deliver the premises, these type of lease assignments typically are included in a stand-alone three-party agreement or in a rider to the lease.<sup>77</sup>

If the franchisee owns the premises, the franchisor will need a different form of agreement to have the ability to take over the possession of the premises. This agreement may take the form of an option to purchase the real estate or a contingent lease.

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<sup>77</sup> *But see Dunkin’ Donuts Inc. v. Dowco, Inc.*, No. civ. 5:98-cv-166, 1998 WL 160823 (N.D.N.Y. Mar. 31, 1998) (granting a preliminary injunction enforcing a lease option agreement upon termination of a franchise agreement even though the lease option agreement was signed only by the franchisee and not Dunkin’ Donuts, the franchisor). In *Dowco*, the court held that a lease option agreement was a unilateral option contract under New York law and therefore need only be signed by the party against whom it is enforced. *Id.* at \*4. The court found that the recited consideration in the franchise agreement for the lease option agreement – the grant of the franchise to franchisee Dowco and the approval of the location – was sufficient to establish an enforceable unilateral option contract. *Id.* It further held that once the option agreement was exercised, Dunkin’ Donuts’ obligation to pay rent to the landlord was sufficient to establish a bilateral agreement between it and the landlord. *Id.*

ii. Purchase of Equipment and Fixtures

Franchise agreements typically go into great detail concerning a franchisee's obligations following the termination or expiration of the franchise relationship. If a franchisor may want to take over the operations of the franchisee's business, one of these post-term obligations will certainly be an obligation to transfer the franchisee's interest in any furniture, fixtures and equipment used in the operation of the franchised business. For branded materials, the franchisor may provide that the right, title and interest in those materials will pass to the franchisor automatically (if the franchisee ever held title to those materials), and state law may require that the franchisor compensate the franchisee for those items.<sup>78</sup>

For non-branded furniture, fixtures and equipment, the franchisor typically provides for compensation to the franchisee for those assets, in the event that the franchisor elects to take possession of them. Some state franchise relationship laws may require that compensation be paid to the franchisee of these materials.<sup>79</sup>

iii. Security Agreement

A contractual obligation in the franchise agreement may not be enough to ensure the ability of the franchisor to take control of the assets used in the franchised business. Given their nature, these assets may be more freely moved and sold to third-parties. To prevent this – or, at least, to provide the franchisor with additional rights against a third-party purchaser – a franchisor may obtain a security interest in the furniture, fixtures, equipment and inventory of the franchisee's business. Once the franchisor has provided for the security interest contractually, it should also perfect the interest by making the appropriate UCC filings under state law.

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<sup>78</sup> See, e.g., Wisc. Stat. § 135.045 (repurchase of branded inventory on termination).

<sup>79</sup> See, e.g., Mich. Comp. Laws §445.1527(d), (requiring repurchase of certain inventory, supplies, equipment, fixtures, and furnishings on nonrenewal); Ark. Code Ann. §4-72-209; Haw. Rev. Stat. §482E-6(3); Ill. Comp. Stat. Sec. 705/20. In the absence of a state law requiring payment of compensation, at least one court has upheld that a “forced sale” provision on termination (by franchisee) even though the valuation was substantially below market. *Snelling & Snelling, Inc. v. Martin*, No. C 97-4479 FMS, 1998 WL 56995 (N.D. Ca. Jan. 28, 1998) ( holding price was not unconscionable because the valuation mechanism was not adopted through oppression or surprise, and it did not “shock the conscience” because at the time of agreement, it would not have necessarily led to grossly unfair price). See also *Soft Pretzel Franchise Systems, Inc. v. Taralli, Inc.*, No. 13-3790, 2013 WL 5525015 (E.D. Penn. Oct. 4, 2013) (enforcing an equipment buy-back provision, stating “[t]he general rule in Pennsylvania, as elsewhere, is that courts are required to give effect to the language of contracts ... if that language is clear and unambiguous.” (quoting *Tran v. Metro. Life Ins. Co.*, 408 F. 3d 130, 136 (3d Cir. 2005)).

iv. Telephone Number Assignment

For franchise systems that rely on local telephone numbers<sup>80</sup> as an important contact point with customers, the ability of the franchisor to continue to use the phone number previously used by the franchisee may be key to the seamless transfer of operations. To accomplish this, the franchisor will likely need more than a franchise agreement provision purporting to assign the number from the franchisee to the franchisor. The telephone company may require a notarized assignment or an instrument appointing the franchisor as the franchisee's attorney-in-fact for the purpose of executing the documents necessary to document the transfer.

v. Other

None of the preceding mechanisms – even if taken together – purport to “buy the business” from the franchisee. While franchisee advocates will often claim that a franchisee should be compensated for the value of their business as a going concern upon termination of the franchise agreement, for the purposes of the discussion in this section, we have assumed that the franchise agreement has been terminated or expired and, therefore, there is no business to be acquired from the franchisee that would require compensation, apart from the assets used in the business.

Except for cases arising under some state statutory provisions providing for compensation to innocent franchisees for the non-renewal of their franchise agreements,<sup>81</sup> courts have held that compensation is not required to be paid to a terminated franchisee.<sup>82</sup> Of course, if the franchisor agrees to provide compensation to the franchisee for the ongoing value of the franchisee's business, it should expect that a court will enforce that term. For example, in *Martin v. Bimbo Foods Bakeries Dist., LLC*,<sup>83</sup> the Distribution Agreement provided that Bimbo would “be authorized to sell [plaintiff's] Distribution Rights to a purchaser at the best price which can be obtained ... for the account of the [plaintiff].”<sup>84</sup> There, the court not only found that the plaintiff had sufficiently alleged that it was entitled to compensation, but that it would be entitled to the “best price.”<sup>85</sup>

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<sup>80</sup> To the extent that a franchisee may own or control accounts for other methods of communications – like URLs, e-mail, websites, social media accounts, etc. – a franchisor may want to utilize the same or a similar agreement to ensure that it has the ability to cause the providers of those service providers to transfer control to the franchisor. This is true even if the franchisee is not permitted by the franchise agreement to operate these methods of communications independently.

<sup>81</sup> See Haw. Rev. Stat. §482E-6(3); Ill. Comp. Stat. Ann. 705/20; Wash. Rev. Code §19.100.180(2)(i).

<sup>82</sup> *Dunkin' Donuts of America, Inc. v. Middletown Donut Corp.*, 495 A.2d 66 (N.J. 1985) (holding “if the parties choose to contract for a forfeiture, a court of equity will not interfere with that contract term in the absence of fraud, accident, surprise, or improper practice” (citing *Osberg Constr. Co. v. City of The Dalles*, 300 F. Supp. 442, 447 (D. Ore. 1969))).

<sup>83</sup> No. 5:15-CV-96-BR, 2015 WL 1884994 (E.D.N.C. Apr. 24, 2015).

<sup>84</sup> *Id.* at \*4.

<sup>85</sup> *Id.* at \*5.

## C. Enforcing Buyback and Assumption Provisions

Because the need to enforce assumption rights usually occur with a failing, disgruntled, or non-compliant franchisee, the franchisee may often times be unwilling to let the franchisor step-in and takeover the location. A franchisor in such a situation would therefore have to seek injunctive relief from a court and be prepared to establish that it will suffer irreparable harm if it is not allowed to exercise its step-in rights.

For example, in *Charter Practices Int'l, LLC v. Robb*,<sup>86</sup> the franchisor, Charter Practices International (“CPI”) delivered a notice of termination to the franchisee for administering half-doses of rabies vaccines, which was found to be a violation of the Connecticut Unfair Trade Practice Act, and therefore provided good cause for termination.<sup>87</sup> The notice of termination was issued December 7, 2012 and stated that the franchise was terminated effective February 5, 2013, i.e. 60 days after the date of the notice.<sup>88</sup> The notice also informed the franchisee that CPI would step-in and operate the franchise until the termination date pursuant to the following provision in the parties’ franchise agreement:

### 9.10. Step-In Rights

9.10.1. In order to prevent any interruption of the operation of the Hospital that would cause harm to the Hospital or to the reputation of the Network, You authorize CPI or its designee to step in to operate the Hospital if, in CPI’s reasonable judgment: . . . CPI decides that significant operational problems exist which require CPI to operate the Hospital for a time.

9.10.2. All revenue derived during CPI’s operation of the Hospital will be for Your exclusive account. CPI may pay from that revenue all expenses, debts, and liabilities incurred during CPI’s operation of the Hospital, including [royalty fees] and any other amounts due under this Agreement. . . .

9.10.3. CPI will maintain in a separate account all revenue generated by the operation of the Hospital, less the expenses referred to in Section 9.10.2.<sup>89</sup>

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<sup>86</sup> 3:12-CV-1768 (RNC), 2017 WL 4366717 (D. Conn. Sept. 30, 2017)

<sup>87</sup> *Id.* at \*3.

<sup>88</sup> *Id.*

<sup>89</sup> See Verified Complaint, *Charter Practices Int'l, LLC v. Robb*, Case No. 3:12-cv-01768-RNC, Doc. 1 (D. Conn Dec. 17, 2012).

CPI exercised its step-in rights and designated an affiliate to operate the business.<sup>90</sup> However, when the franchisee took steps to interfere with CPI's operation of the business,<sup>91</sup> CPI filed suit for breach of contract and sought a temporary restraining order and a preliminary injunction.<sup>92</sup> In granting CPI's motion for temporary restraining order, the court found that CPI showed that the franchisee's conduct

would constitute a violation of the [franchisee]'s obligation under the Agreement to permit [CPI] to operate the Hospital without interference. The full extent of the harm caused by such conduct in terms of the morale and well-being of the staff, and also the reputation and goodwill of the plaintiffs and their trademarks, would be difficult to quantify. The defendant's interest in being able to visit the premises to protest his wrongful termination or for other purposes is outweighed by the plaintiffs' interest in operating the Hospital free from further interference by the defendant. The Court finds that a TRO restraining the defendant from returning to the premises pending a hearing on the plaintiffs' motion for a preliminary injunction is therefore necessary and appropriate.<sup>93</sup>

The franchisee in *Robb* also counterclaimed for breach of contract, contending that exercising step-in rights was equivalent to a termination and deprived him of the 60 days' notice required pursuant to the Connecticut Franchise Act.<sup>94</sup> However, because the franchise agreement expressly stated that revenue would accrue to the franchisee's account, and the notice of termination confirmed that revenue would be credited to the franchisee's account until the termination would become effective on February 5, 2013, the court found that the franchise agreement was clear that the franchisee owned the hospital until the date of termination.<sup>95</sup> Therefore, the court granted summary judgment in CPI's favor on the franchisee's counterclaim.<sup>96</sup>

Where the franchisor owns the real property where the franchised business is located, courts have found that the inability of a franchisor to make productive use of its

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<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> Temporary Restraining Order and Order to Show Cause, *Charter Practices Int'l, LLC v. Robb*, Case No. 3:12-cv-01768-RNC, Doc. 11-1 at 5 (Dec. 18, 2012 D. Conn.)

<sup>94</sup> *Robb*, 2017 WL 4366717 at \*3; see also Conn. Gen. State. Sec. 42-133e (providing that a franchise cannot be terminated without good cause and 60 days' notice).

<sup>95</sup> *Robb*, 2017 WL 4366717 *Id.* at \*4.

<sup>96</sup> *Id.*

own property constitutes requisite irreparable harm to support injunctive relief in cases where a franchisee refuses to surrender possession to the franchisor.<sup>97</sup>

Whether a franchisor is successful in enforcing a right of first refusal provision will often turn on the express language of the contract and whether the parties complied with the applicable requirements and conditions. The franchisor in *Dunkin' Donuts, Inc. v. NJS, Inc.*,<sup>98</sup> successfully enforced its right to purchase a franchised business pursuant to a right of first refusal provision contained in the franchise agreement. After defaulting the franchisee in *NJS*, the franchisor entered into a settlement agreement that required the franchisee to sell the franchised business within 90 days, consistent with the right of first refusal as outlined in the parties' franchise agreement.<sup>99</sup> The relevant language stated:

If the Franchisee . . . has received and desires to accept a signed, bona fide written offer from a third party . . . , the Franchisee shall notify and provide Dunkin' Donuts with a copy of such offer, and Dunkin' Donuts shall have the right and option, exercisable within forty-five (45) days after its receipt of a copy of the offer to purchase the Franchisee's franchise . . . on the same terms and conditions as offered by said third party.<sup>100</sup>

The Settlement Agreement further required that Dunkin' Donuts could require the current and prospective franchisee to comply with certain technicalities before the transaction became effective:

Franchisee[] and the prospective purchaser of the Franchise shall comply with all of the . . . procedures and documentation, as may be modified herein, generally used by Dunkin' in such transactions.<sup>101</sup>

The franchisee delivered a proposed purchase and sale agreement on June 29, 1994.<sup>102</sup> In response, Dunkin' required that the franchisee send a duplicate original with all deletions and changes initialed.<sup>103</sup> The franchisee complied and delivered a revised purchase and sale agreement on July 25, 1994.<sup>104</sup> Dunkin' thereafter exercised its intent

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<sup>97</sup> See, e.g. *7-Eleven v. Spear*, No. 10-cv-6697, 2011 WL 830069, at \*6 (N.D. Ill. Mar. 3, 2011) (where franchisor was deprived of contractual right to possession of the store following termination of franchise agreement, injunctive relief ordered in its favor); *Persaud v. Exxon Corp.*, 867 F. Supp. 128, 141 (E.D.N.Y. 1994) (finding irreparable harm where franchisee continued to occupy the premises, depriving the franchisor of the ability to make productive use of the site).

<sup>98</sup> 889 F. Supp. 1074 (N.D. Ill. 1995).

<sup>99</sup> *Id.* at 1075.

<sup>100</sup> *Id.*

<sup>101</sup> *Id.* at 1077.

<sup>102</sup> *Id.*

<sup>103</sup> *NJS*, 889 F. Supp. at 1077.

<sup>104</sup> *Id.*

to exercise its right of first refusal, but the franchisee asserted that the notice of intent was not timely.<sup>105</sup> Dunkin' filed suit for breach of contract of the settlement agreement for failing to accept the option to purchase.<sup>106</sup>

Citing to the above express language of the settlement agreement, the court first determined that Dunkin' had a right to reject the first purchase and sale agreement for failure to provide initialed documents.<sup>107</sup> The second issue before the court was whether the rejection of the first purchase and sale agreement tolled the 45-day period until the revised agreement was received.<sup>108</sup> Because Dunkin' required that the parties comply with the "procedures generally used" by Dunkin' in such transactions, the court found that the 45-day period did not begin to run until Dunkin' received a complete, initialed document.<sup>109</sup> Accordingly, the court granted summary judgment on Dunkin's claim for breach of contract and specific performance.<sup>110</sup>

#### **D. Disclosure Obligations**

Under the NASAA Guidelines, the principal disclosure obligations relating to buyback and assumption rights and obligations are contained in Item 17.<sup>111</sup> In particular, a cross-reference to relevant contract sections and brief summaries should be included in connection with the following provisions, where applicable:

- i. Franchisee's obligations on termination/nonrenewal;
- n. Franchisor's right of first refusal to acquire franchisee's business; and
- o. Franchisor's option to purchase franchisee's business.<sup>112</sup>

#### **E. Practice Tips**

*In re Meena*,<sup>113</sup> serves as a potent reminder that any measure of caution in drafting buyback provisions must be coupled with equal caution exercised in the execution of and performance under those agreements. There, the franchisees executed multiple franchise agreements, subleases, and security agreements (and UCC-1 financing statements were filed) in their individual capacities.<sup>114</sup> After delivering a notice of default and termination, GNC – the franchisor – filed suit against and entered a settlement agreement with the individual franchisees.<sup>115</sup> When the franchisees defaulted under the settlement agreement, GNC sought to enforce the settlement agreement and obtained a

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<sup>105</sup> *Id.* at 1076.

<sup>106</sup> *Id.*

<sup>107</sup> *Id.* at 1077.

<sup>108</sup> *NJS*, 889 F. Supp. at 1077.

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> NASAA Guidelines, *supra* note 56, at 56.

<sup>112</sup> *Id.*

<sup>113</sup> 8-18-74693-REG, 2018 WL 5880916, at \*1 (Bankr. E.D.N.Y. Nov. 6, 2018).

<sup>114</sup> *Id.* at \*2.

<sup>115</sup> *Id.* at \*4.

consent order against the individual franchisees to force them to turn over the keys to their respective units.<sup>116</sup> The franchisees and corporate entities formed by the franchisees all filed for bankruptcy.<sup>117</sup>

Although the parties never documented the transfer of the franchises to the corporate entities, as the franchise agreement contemplated, each of the corporate entities purchased goods directly from GNC.<sup>118</sup> The franchisees did not make any purchases from GNC in their individual capacities.<sup>119</sup> Consequently, the bankruptcy court held that all the inventory intended by GNC to be covered by the UCC-1 financing statements was owned by the corporate entities, and because the corporate entities did not name those entities as the debtors, the financing statements were not sufficient to establish GNC's security interest.<sup>120</sup>

The bankruptcy court went further. It was also not satisfied that the franchise agreements and subleases had been terminated. While the notices of termination provided for immediate termination, the court noted that the settlement agreement required the franchisees to comply with the franchise agreements, and the consent order reiterated the rights of the parties under the franchise agreements.<sup>121</sup>

GNC clearly had powerful contractual tools to use to allow it to take over the operation of the franchised stores in *In re Meena*. Unfortunately for GNC, though, the tools could not be used as they were intended because the company did not pay enough attention to the identity of the parties, and because it did not clearly and consistently communicate to the franchisee when and how the franchise agreement were terminated.

In a similar fashion, in *Sensormatic Electronics Corp. v. First National Bank Pennsylvania*,<sup>122</sup> Sensormatic had a contractual right to repurchase the franchisee's business by providing the franchisee with "not less than ninety (90) days written notice."<sup>123</sup> Sensormatic attempted to exercise that right by providing only 47 days' notice. Not surprisingly, the court granted summary judgment against Sensormatic, finding that the option was forfeited once the 90 day notice period had passed.<sup>124</sup>

## V. CONCLUSION

A franchisor's right to take over the operation of a franchisee's business should not be done without substantial planning. A franchisor must anticipate – sometimes a decade or more in advance – the potential need or desirability to step in and take control of the franchisee's location and ensure that its agreements sufficiently provide for the rights that

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<sup>116</sup> *Id.*

<sup>117</sup> *Id.* at \*5.

<sup>118</sup> *In re Meena*, 2018 WL 5880916, at \*5.

<sup>119</sup> *Id.* at \*6.

<sup>120</sup> *Id.* at \*7.

<sup>121</sup> *Id.* at \*8.

<sup>122</sup> 148 Fed. Appx. 99 (3d Cir. 2005).

<sup>123</sup> *Id.* at 101.

<sup>124</sup> *Id.* at 103.

it may want to exercise one day. If the necessary rights are included in those agreements, a franchisor must also evaluate whether it has the available resources to make the exercise of those rights make sense. Depending on the circumstances, a franchisor may also be advised to work with the franchisee and enter into an agreement regarding the specific terms and conditions of the exercise of the franchisor's right, which may be dictated by the unique issues giving rise to the need to step-in. Finally, a franchisor must be aware of the stakes involved for the franchisee. The franchisor's operation of the franchisee's business on the franchisee's behalf or the take-over of the franchisee's business at the end of the relationship poses the possibility for significant losses for the franchisee (and, potentially, a windfall for the franchisor), which may raise the risk of legal liability to the franchisor.

## APPENDIX 1

### IN-TERM STEP-IN RIGHTS SAMPLE FRANCHISE AGREEMENT PROVISIONS

#### **1. Operation Upon Death or Disability**

1.1. Manager Required. If, upon the death or permanent disability of Franchisee, or upon the death or permanent disability of an owner of a controlling interest in Franchisee if Franchisee is an entity, the Franchised Business is not being managed by a trained and approved manager, Franchisee or such owner's executor, administrator, conservator, guardian or other personal representative must within a reasonable time, not to exceed fifteen (15) days from the date of death or permanent disability appoint a manager to operate the Franchised Business. Such manager will be required to complete training at Franchisee's expense within sixty (60) days of being appointed to operate the Franchised Business.

1.2. Step-In Right. Pending the appointment of a manager as provided herein or if, in Franchisor's reasonable judgment, the Franchised Business is not being managed properly any time after Franchisee's death or disability or after the death or permanent disability of the owner of a controlling interest in Franchisee, Franchisor has the right, but not the obligation, to assume the management of the Franchised Business or appoint a third party to assume its management in order to prevent any interruption of the Franchised Business. All funds from the operation of the Franchised Business while it is under Franchisor's (or the third party's) management will be kept in a separate account, and all expenses of the Franchised Business, including compensation, other costs and travel and living expenses of Franchisor (or the third party) will be charged to this account. Franchisor also has the right to charge Franchisee (in addition to royalty fees, marketing fund contributions, and other amounts due under this Agreement) a reasonable management fee during the period that the Franchised Business is managed by Franchisor (or the third party). While the operation of the Franchised Business will be on Franchisee's behalf, Franchisor (or the third party) has a duty to utilize only reasonable efforts and will not be liable to Franchisee or Franchisee's owners for any debts, losses, or obligations the Franchised Business incurs, or to any of Franchisee's creditors for any products, other assets, or services the Franchised Business purchases, while Franchisor (or the third party) manages it.

1.3. "Permanent Disability" Defined. As used herein, the term "permanent disability" means a mental or physical disability, impairment or condition that is reasonably expected to prevent or actually does prevent Franchisee or an owner of a controlling interest in Franchisee from managing and operating the Franchised Business for a period of three (3) months from the onset of such disability, impairment or condition.

#### **2. Franchisor's Step-In Rights.**

2.1. To prevent any interruption of the business of the Franchised Business and any injury to the goodwill and reputation thereof which may be caused thereby, Franchisee authorizes Franchisor to assume operations and/or management of the Franchised Business (or to appoint a third party to assume its management) for any period of time Franchisor deems appropriate but not to exceed 90-day increments, renewable for up to one year, in the aggregate. Franchisor (or a third party) may assume the management of the Franchised Business under the following circumstances:

*These provisions are merely samples and are provided for informational purposes only. They do not reflect the opinions or specific positions of the authors.*

- (a) if Franchisee abandons or fails to actively operate the Franchised Business;
- (b) any allegation or claim is made against the Franchised Business, Franchisee or any of Franchisee's principals, officers, directors or employee, involving or relating to misrepresentations, criminal conduct, or any fraudulent or deceptive practice;
- (c) if Franchisee fails to comply with any provision of this Agreement or any System Standard and does not cure the failure within the time period Franchisor specifies in its notice to Franchisee.

2.2. If Franchisor (or a third party) assumes the management of the Franchised Business pursuant to this Section, Franchisee agrees to pay Franchisor (in addition to the Royalty Fee, Marketing Fund contributions, and other amounts due under this Agreement) an amount equal to [\_\_\_\_] percent of Gross Sales, plus Franchisor's (or the third party's) direct out-of-pocket costs and expenses, for any period Franchisor deem appropriate. If Franchisor (or a third party) assumes the management of the Franchised Business, Franchisee acknowledges that Franchisor (or the third party) will have a duty to utilize only reasonable efforts and will not be liable to Franchisee or Franchisee's owners for any debts, losses, or obligations the Franchised Business incurs, or to any of Franchisee's creditors for any supplies, products, or other assets or services the Franchised Business purchases, while Franchisor (or the third party) manages the Franchised Business.

2.3. If Franchisor exercises its rights under this Section, Franchisor's right to terminate this Agreement shall not otherwise be affected.

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## APPENDIX 2

### IN-TERM PURCHASE RIGHTS SAMPLE FRANCHISE AGREEMENT PROVISIONS

#### 1. Right of First Refusal.

1.1. Bona Fide Offer. If Franchisee (or any of Franchisee's owners) at any time determine to sell, assign or transfer for consideration an interest in this Agreement and the Franchised Business or an ownership interest in Franchisee, Franchisee (or such owner) agrees to obtain and deliver a *bona fide* written offer or proposal to purchase from a responsible, arms-length and fully disclosed buyer, along with all pertinent documents including any contract or due diligence materials, to Franchisor.

1.2. Franchisor's Right of First Refusal. Franchisor shall, for thirty (30) days from the date of delivery of all such documents, have the right, exercisable by written notice to Franchisee, to purchase the offered assets or interest for the price and on the same terms and conditions contained in such offer communicated to Franchisee, provided that:

- (a) Franchisor has the right to substitute cash for the fair market value of any form of payment proposed in such offer;
- (b) Franchisor's credit shall be deemed at least equal to the credit of any proposed buyer;
- (c) After providing notice to Franchisee of Franchisor's intent to exercise this right of first refusal, Franchisor shall have up to sixty (60) days to close the purchase;
- (d) Franchisor shall be entitled to receive from Franchisee all customary representations and warranties given by Franchisee as the seller of the assets or such ownership interest or, at Franchisor's election, such representations and warranties contained in the proposal.

1.3. Non-Exercise of Right of First Refusal. If Franchisor does not exercise this right of first refusal within sixty (60) days, the offer or proposal may be accepted by Franchisee or any of its owners, subject to Franchisor's prior written approval in accordance with the transfer provisions of this Agreement. Should the sale fail to close within sixty (60) days after the offer is delivered to Franchisor, or should there be a material change in the terms of the sale offer (which Franchisee shall promptly provide written notice thereof to Franchisor), Franchisor shall have an additional right of first refusal during the 30-day period following either the expiration of the sixty (60)-day period or Franchisor's receipt of notice of the material change in the sale's terms, either on the terms originally offered or the modified terms, at Franchisor's option. Franchisor's right of first refusal shall renew and be implemented in accordance with this Section.

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## 2. Option to Purchase

2.1. Exercise of Option. Franchisor or its designated affiliate shall have the right and option (the **Purchase Option**) exercisable at any time following the Trigger Date, upon written notice to Franchisee (the **Option Notice**) to purchase for the Purchase Price (as defined below) all of the Assets, free and clear of all liens, encumbrances and liabilities. If Franchisor receives a written request for its consent to an transfer pursuant to Section [\_\_\_], then Franchisor must exercise the Purchase Option, if at all, within [\_\_\_] days following receipt of Franchisee's request for consent to the transfer. The Purchase Option shall be automatically reinstated following: (a) the transfer; (b) Franchisor's refusal to consent to the proposed transfer; (c) [\_\_\_] days after the expiration of the period in which Franchisor may exercise its right of first refusal under Section [\_\_\_], if Franchisor does not exercise the right of first refusal and the Transfer has not been concluded; or (d) if there has been any material change in the terms of the proposed offer which results in the reinstatement of the its right of first refusal under Section [\_\_\_].

- (a) At Franchisor's request, the terms and conditions of the Purchase Option may be recorded in the real property records under applicable law, and Franchisee shall execute all documents as may be necessary and appropriate to do so. Franchisor's rights under this Section [\_\_\_] shall be in addition to, and not in lieu of, Franchisor's its right of first refusal under Section [\_\_\_] and such rights may be exercised separately, concurrently or in the alternative.

2.2. Purchase Price. Subject to the conditions in this Section, Franchisee may select one of two methodologies to determine the purchase price of the Assets (the **Purchase Price**): (i) the Fair Market Value of the Assets; or (ii) [\_\_\_] ([\_\_\_]) times EBITDA during the 12 full calendar months immediately preceding Franchisee's receipt of the Option Notice. Franchisee will make its selection within [\_\_\_] days after receipt of the Option Notice, by notifying Franchisor in writing of its choice of methodology. If Franchisee fails to make a timely selection of methodology, then the methodology used to determine Purchase Price will be chosen by Franchisor.

- (a) **EBITDA** shall be determined by using Franchisee's financial statements, provided Franchisee has kept and maintained financial statements in compliance with the provisions Franchisee's franchise agreements with Franchisor and the Manuals. The chief financial officer or chief executive officer of Franchisee (or Franchisee, if an individual) shall certify that such financial statements are true, correct, and complete, subject to any adjustment in the event of any audit or other investigation of such financial statements and/or the books and records by Franchisor. If an audit or other investigation reveals any inaccuracy, then, in addition to all other rights and remedies, Franchisor shall have the right to revise the Purchase Price, and if the inaccuracy overstates EBITDA during the applicable 12-month period

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by [\_\_]% or more, then Franchisee shall reimburse Franchisor for the expenses of the audit/investigation.

(b) **“Fair Market Value”** shall be determined as follows:

- (i). Franchisee and Franchisor shall attempt to select a mutually acceptable appraiser within [\_\_] days following the date of the Option Notice, in which case Fair Market Value shall be determined by such appraiser.
- (ii). If Franchisee and Franchisor fail to so agree on an appraiser, then within [\_\_] days following the date of the Option Notice, Franchisor shall select one appraiser, and Franchisee shall select one appraiser. If either Franchisee or Franchisor fails to timely appoint an appraiser, then the appraiser appointed by the other party shall be the sole appraiser for the purposes of determining Fair Market Value. Each party shall promptly advise the other party in writing of the identity of its appointed appraiser. Fair Market Value shall be: (a) if one appraiser is appointed, the value established by that appraiser; or (b) if 2 appraisers are appointed, the arithmetic average of the values determined by the appraisers; provided, that if the higher value is more than [\_\_]% of the lower value, then the 2 appraisers will jointly select a third appraiser, and the Fair Market Value shall then be the arithmetic average of (1) the value determined by the 3rd appraiser and (2) the value determined by the one of the first 2 appraisers that is nearest in value to the value determined by the 3rd appraiser. If the first 2 appraisers are unable to agree upon a 3rd appraiser within [\_\_] days of their completion of appraisals, then either Franchisee or Franchisor may demand the appointment of an appraiser by the then-director of the regional office of the American Arbitration Association located nearest to Franchisor’s headquarters, in which event the appraiser appointed thereby shall be the third appraiser.
- (iii). Each of the appraisers shall conduct an appraisal within [\_\_] days after being appointed, and shall submit their appraisals in writing to Franchisee and to Franchisor within such period.
- (iv). Fair Market Value shall be determined solely by reference to the Franchised Business, and the appraiser shall be instructed in writing by each party not to, and the appraiser shall not, consider or attribute any value to (a) any goodwill or other value attributable to the System or the [“\_\_\_\_\_”] trademarks other than the right to utilize the System and the trademarks in the operation of Franchised Businesses in accordance with, and for no more than the remaining term of, the Franchise Agreement, or (b) any rights or efficiencies

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Franchisee may enjoy because Franchisee (or any affiliated or related party) operates or has the right to operate more than one Business, if applicable. An appraiser may use a bona fide third-party offer to purchase the Assets in its determination of Fair Market Value if and only if such third-party offer was delivered by Franchisee to Franchisor prior to the exercise of the Purchase Option.

- (v). Any appraiser, to be qualified to conduct an appraisal hereunder, shall be an independent appraiser (i.e., not affiliated with Franchisor or Franchisee), an M.A.I. appraiser or its equivalent or an investment bank, and shall have experience in valuing franchised or licensed businesses. If any appraiser initially appointed under this Agreement shall, for any reason, be unable to serve, a successor appraiser shall be promptly appointed in accordance with the procedures pursuant to which the predecessor appraiser was appointed.
  - (vi). The costs of all appointed appraisers shall be borne by the Franchisor if the parties have been able to mutually agree to the selection of a single appraiser. If, however, the parties cannot agree, and two or three appraisers are appointed then the costs of all appointed appraisers shall be borne by the Franchisee.
- (c) **“Assets”** means all of the following personal property and assets owned by Franchisee or in which Franchisee otherwise has any rights, and located at, or used in connection with the Franchised Business: (a) all accounts, licenses, permits, and contract rights, including this Agreement, leasehold interests, all telephone and fax numbers, telephone and other directory listings, general intangibles, receivables, claims of Franchisee, all guaranties and security therefor and all of Franchisee’s right, title and interest in the goods purchased and represented by any of the foregoing; (b) all chattel paper including electronic chattel paper and tangible chattel paper; (c) all documents and instruments; (d) all letters of credit and letter-of-credit rights and all supporting obligations; (e) all deposit accounts; (f) all investment property and financial assets; (g) all inventory and products thereof and documents therefor; (h) all furniture, fixtures, equipment, leasehold improvements and machinery, wherever located and all documents and general intangibles covering or relating thereto; (i) all books and records pertaining to the foregoing, including computer programs, data, certificates, records, circulation lists, subscriber lists, advertiser lists, supplier lists, customer lists, customer and supplier contracts, sales orders, and purchasing records; (j) all software including computer programs and supporting information; (k) all commercial tort claims; (l) all other personal property of Franchisee of any kind; and (m) all proceeds of the foregoing, including proceeds of insurance policies.

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- (d) Franchisor may exclude and elect not to purchase cash (or its equivalent), any notes or accounts payable to Franchisee by any person or party except by an arms-length transaction with a person not related to or affiliated with Franchisee, and any Assets that are not necessary or appropriate (in function or quality) to a Franchised Business' operation or do not meet the current System standards, and, if applicable, the Fair Market Value shall reflect such exclusions.
- (e) Franchisor and each appointed appraiser shall be given full access during normal business hours to all information required and relevant to determine EBITDA and/or Fair Market Value.
- (f) If the Assets include a fee simple interest in real property, then all revenue derived from such real property shall be excluded from EBITDA and the value of such real property shall be the Fair Market Value of the real property.

2.3. The Purchase Price shall be adjusted by setting off and reducing the Purchase Price by any amount then owing by Franchisee to Franchisor or its Affiliates or to any appraiser, and any amounts that Franchisor pays in its sole discretion to cure Franchisee's defaults with third parties.

2.4. All sales and transfer taxes are the responsibility of Franchisee and shall be paid when due.

2.5. Franchisee shall make written representations and warranties to Franchisor or its designated purchaser of the Assets customary for transactions of the type, including (1) its power, authority and legal capacity to sell, transfer and assign the Assets, (2) valid right, title and interest in the Assets, (3) the absence of all liens, encumbrances and liabilities on the Assets, and (4) the absence of any violation, in any material respect, or default under, or acceleration of any material agreement or instrument pursuant to which the Assets are encumbered or bound as the result of such sale. Franchisee and its Owners shall sign covenants obligating them to comply with the obligations under this Agreement that survive the termination or expiration of the Agreement (including Section [ ] [restrictive covenants]) and general releases, on a form prescribed by Franchisor of any and all known and unknown claims against Franchisor and its Affiliates and their owners, officers, directors, agents, and employees.

2.6. Pending the closing of any Purchase Option transaction: (i) Franchisee shall operate the Franchised Business in accordance with this Agreement; and (ii) Franchisor will have the right to (a) appoint a manager to maintain and/or supervise the Franchised Business, and (b) communicate with Franchisee's employees regarding employment opportunities following the closing (though Franchisor shall not be obligated to hire such employees). Franchisee will indemnify and hold Franchisor harmless against all obligations incurred in connection with the Franchised Business prior to the closing of Purchase Option transaction.

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2.7. The closing of any transaction shall take place as soon as is reasonably possible, and both parties agree to act diligently and to cooperate with one another to complete closing as soon as possible, subject to the satisfaction of customary conditions to closing in favor of Franchisor, which may be waived by Franchisor. Closing shall occur within [ ] days from Franchisor's exercise of its Purchase Option. If closing occurs before the end of the term of this Agreement, the parties shall be deemed to have mutually agreed to terminate this Agreement.

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## APPENDIX 3

### POST-TERM BUYBACK AND TAKEOVER RIGHTS

#### SAMPLE FRANCHISE AGREEMENT PROVISIONS

##### 1. Post-Term Purchase Option.

- (a) Exercise of Option. Upon the termination, expiration or non-renewal of this Agreement by Franchisor or Franchisee for any reason, Franchisor shall have the option, exercisable by giving written notice thereof within thirty (30) days from the date of such termination, expiration or non-renewal to purchase any and all inventory, equipment, furniture, fixtures, signs, sundries and supplies owned by Franchisee and used in the Franchised Business, at the lesser of: (i) Franchisee's cost less depreciation computed on a reasonable straight line basis (as determined in accordance with generally accepted accounting principles and consistent with industry standards and customs) or (ii) fair market value of such assets, less (in either case) any outstanding liabilities of the Franchised Business. In addition, Franchisor shall have the option to assume Franchisee's lease for the lease location of the Franchised Business, or if an assignment is prohibited, a sublease for the full remaining term on the same terms and conditions as Franchisee's lease. No value will be attributed to the value of the Marks or the system or to the assignment of the lease (or sublease) for the premises or the assignment of any other assets used in conjunction with the Franchised Business, and Franchisor will not be required to pay any separate consideration for any such assignment or sublease.
- (b) Fair Market Value. If the parties cannot agree on fair market value within thirty (30) days of Franchisor's notice of intent to purchase, fair market value shall be determined by an experienced, professional and impartial third party appraiser without regard to goodwill or going concern value, designated by Franchisor and acceptable to Franchisee, whose determination shall be final and binding on both parties. The cost of such appraisal shall be borne equally by Franchisor and Franchisee. If the parties cannot agree upon an appraiser one shall be appointed by the American Arbitration Association, upon petition of either party.
- (c) Liabilities. Franchisor shall have the right to withhold from the purchase price funds sufficient to pay all outstanding debts and liabilities of Franchisee and the Franchised Business and to pay such debts and liabilities from such funds. If such liabilities exceed the purchase price of the inventory, equipment, furniture, fixtures and signs, Franchisor shall apply the purchase price in such a manner as Franchisor, in its own discretion, shall determine. In no event, however, shall Franchisor become liable for any of the debts and liabilities of Franchisee or the Franchised Business and Franchisee shall remain responsible for all outstanding debts and liabilities of the Franchised Business that remain

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unsatisfied subsequent to the distribution by Franchisor of the purchase price of the funds.

- (d) Closing. The purchase price shall be paid in cash at the closing of the purchase, which shall take place no later than ninety (90) days after receipt by Franchisee of Franchisor's notice of exercise of this option to purchase the inventory, equipment, furniture, sundries and signs at which time Franchisee shall deliver instruments transferring to Franchisor or its nominee: (1) good and merchantable title to the inventory, equipment, furniture, sundries and signs purchased, free and clear of all liens and encumbrances (other than liens and security interests acceptable to Franchisor), with all sales and other transfer taxes paid by Franchisee; and (2) all licenses and permits which may be assigned or transferred. In the event that Franchisee cannot deliver clear title to all of the inventory, equipment, furniture, sundries and signs purchased as aforesaid, or in the event there shall be other unresolved issues, the closing of the sale shall be accomplished through an escrow arrangement. Further, Franchisee and Franchisor shall, prior to closing, comply with the applicable Bulk Sales provisions of the Uniform Commercial Code as enacted in the state where the Franchised Business is located. If Franchisor exercises this option to purchase the inventory, equipment, furniture, fixtures, sundries and signs pending the closing of such purchase as herein above provided, Franchisor shall have the right to appoint a manager to maintain the operation of the Franchised Business, in accordance with the relevant provisions of Section [ ] hereof. Alternatively, Franchisor may require Franchisee to close the Franchised Business during such time period without removing therefrom any inventory, equipment, furniture, sundries and signs. Franchisee shall maintain in force all insurance policies required by Section [ ] hereof until the date of closing.

## APPENDIX 3 (con.)

### EXHIBIT [ ] TO THE FRANCHISE AGREEMENT

#### CONDITIONAL ASSIGNMENT AND ASSUMPTION OF LEASE

**THIS COLLATERAL ASSIGNMENT AND ASSUMPTION OF LEASE** (this “**Assignment**”) is made, entered into and effective as of the effective date of the Lease (as defined below), by, between and among [**Franchisor**], with its principal business address located at \_\_\_\_\_ (the “**Franchisor**”), and \_\_\_\_\_ whose current principal place of business is \_\_\_\_\_ (the “**Franchisee**”).

#### RECITALS

The Franchisor entered into a Franchise Agreement (the “**Franchise Agreement**”) dated as of \_\_\_\_\_, 20\_\_ with the Franchisee, pursuant to which the Franchisee plans to own and operate a [Franchise Concept] Franchised Business (the “**Franchised Business**”) located at \_\_\_\_\_ (the “**Site**”). In addition, pursuant to that certain Lease Agreement (the “**Lease**”), the Franchisee has leased or will lease certain space containing the Franchised Business described therein from \_\_\_\_\_ (the “**Lessor**”). The Franchise Agreement requires the Franchisee to deliver this Assignment to the Franchisor as a condition to the grant of a franchise.

The Franchisor and the Franchisee agree as follows:

1. **Recitals:** The Recitals are true and correct. This Assignment will be interpreted by reference to, and construed in accordance with, the Recitals.
2. **Incorporation of Terms:** Terms not otherwise defined in this Assignment have the meanings as defined in the Lease.
3. **Indemnification of Franchisor:** The Franchisee agrees to indemnify and hold the Franchisor and its affiliates, stockholders, directors, officers and representatives harmless from and against any and all losses, liabilities, claims, proceedings, demands, damages, judgments, injuries, attorneys’ fees, costs and expenses, that they incur resulting from any claim brought against any of them or any action which any of them are named as a party or which any of them may suffer, sustain or incur by reason of, or arising out of, the Franchisee’s breach of any of the terms of the Lease, including the failure to pay rent or any other terms and conditions of the Lease.
4. **Conditional Assignment:** The Franchisee hereby grants to the Franchisor a security interest in and to the Lease, all of the furniture, fixtures, inventory and supplies located in the Site and the franchise relating to the Franchised Business, and all of the Franchisee’s rights, title and interest in and to the Lease as conditional for the payment  
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of any obligation, liability or other amount owed by the Franchisee or its affiliates to the Lessor arising under the Lease and for any default or breach of any of the terms and provisions of the Lease, and for any default or breach of any of the terms and provisions of the Franchise Agreement. In the event of a breach or default by the Franchisee under the terms of the Lease, or, in the event the Franchisor makes any payment to the Lessor as a result of the Franchisee's breach of the Lease, then such payment by the Franchisor, or such breach or default by the Franchisee, shall at Franchisor's option be deemed to be an immediate default under the Franchise Agreement, and the Franchisor shall be entitled to the possession of the Site and to all of the rights, title and interest of the Franchisee in and to the Lease and to all other remedies described herein or in the Franchise Agreement or at law or in equity, without prejudice to any other rights or remedies of the Franchisor under any other Agreements or under other applicable laws or equities. This Assignment shall constitute a lien on the interest of the Franchisee in and to the Lease until satisfaction in full of all amounts owed by the Franchisee to the Franchisor. In addition, the rights of the Franchisor to assume all obligations under the Lease provided in this Assignment are totally optional on the part of the Franchisor, to be exercised in its sole discretion. Franchisee agrees to execute any and all Uniform Commercial Code financing statements and all other documents and instruments deemed necessary by Franchisor to perfect or document the interests and assignments granted herein.

5. **No Subordination:** The Franchisee shall not permit the Lease to become subordinate to any lien without first obtaining Franchisor's written consent, other than the lien created by this Assignment, the Franchise Agreement, the Lessor's lien under the Lease, liens securing bank financing for the operations of Franchisee on the Site and the agreements and other instruments referenced herein. The Franchisee will not terminate, modify or amend any of the provisions or terms of the Lease without the prior written consent of the Franchisor. Any attempt at termination, modification or amendment of any of the terms without such written consent is null and void.

6. **Exercise of Remedies:** In any case of default by the Franchisee under the terms of the Lease or under the Franchise Agreement, the Franchisor shall be entitled to exercise any one or more of the following remedies in its sole discretion:

- a) to take possession of the Site, or any part thereof, personally, or by its agents or attorneys;
- b) to, in its discretion, without notice and with or without process of law, enter upon and take and maintain possession of all or any part of the Site, together with all furniture, fixtures, inventory, books, records, papers and accounts of the Franchisee;
- c) to exclude the Franchisee, its agents or employees from the Site;
- d) as attorney-in-fact for the Franchisee, or in its own name, and under the powers herein granted, to hold, operate, manage and control the Franchised

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Business and conduct the business, if any, thereof, either personally or by its agents, with full power to use such measures, legally rectifiable, as in its discretion may be deemed proper or necessary to cure such default, including actions of forcible entry or detainer and actions in distress of rent, hereby granting full power and authority to the Franchisor to exercise each and every of the rights, privileges and powers herein granted at any and all times hereafter;

e) to cancel or terminate any unauthorized agreements or subleases entered into by the Franchisee, for any cause or ground which would entitle the Franchisor to cancel the same;

f) to disaffirm any unauthorized agreement, sublease or subordinated lien, to make all necessary or proper repairs, decorating, renewals, replacements, alterations, additions, betterments and improvements to the Site or the Site that may seem judicious, in the sole discretion of the Franchisor; and

g) to insure and reinsure the same for all risks incidental to the Franchisor's possession, operation and management thereof; and/or

h) notwithstanding any provision of the Franchise Agreement to the contrary, to declare all of the Franchisee's rights but not obligations under the Franchise Agreement to be immediately terminated as of the date of the Franchisee's default under the Lease.

7. **Power of Attorney:** The Franchisee does hereby appoint irrevocably the Franchisor as its true and lawful attorney-in-fact in its name and stead and hereby authorizes it, upon and default under the Lease or under the Franchise Agreement, with or without taking possession of the Site, to rent, lease, manage and operate the Site to any person, firm or corporation upon such terms and conditions in its discretion as it may determine, and with the same rights and powers and immunities, exoneration of liability and rights of recourse and indemnity as the Franchisor would have upon taking possession of the Site pursuant to the provisions set forth in the Lease. The power of attorney conferred upon the Franchisor pursuant to this Assignment is a power coupled with an interest and cannot be revoked, modified or altered without the written consent of the Franchisor.

8. **Election of Remedies:** It is understood and agreed that the provisions set forth in this Assignment are deemed a special remedy given to the Franchisor and are not deemed to exclude any of the remedies granted in the Franchise Agreement or any other agreement between the Franchisor and the Franchisee, but are deemed an additional remedy and shall be cumulative with the remedies therein and elsewhere granted to the Franchisor, all of which remedies are enforceable concurrently or successively. No exercise by the Franchisor or any of the rights hereunder will cure, waiver or affect any default hereunder or default under the Franchise Agreement. No inaction or partial exercise of rights by the Franchisor will be construed as a waiver of any of its rights and

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remedies and no waiver by the Franchisor of any such rights and remedies shall be construed as a waiver by the Franchisor of any future rights and remedies.

9. **Binding Agreements:** This Assignment and all provisions hereof shall be binding upon the Franchisor and the Franchisee, their successors, assigns and legal representatives and all other persons or entities claiming under them or through them, or either of them, and the words "Franchisor" and "Franchisee" when used herein shall include all such persons and entities and any others liable for payment of amounts under the Lease or the Franchise Agreement. All individuals executing on behalf of corporate entities hereby represent and warrant that such execution has been duly authorized by all necessary corporate and shareholder authorizations and approvals.

10. **Assignment to Control.** This Assignment governs and controls over any conflicting provisions in the Lease.

11. **Attorney's Fees, Etc.** In any action or dispute, at law or in equity, that may arise under or otherwise relate to this Assignment, the prevailing party will be entitled to recover its attorneys' fees, costs and expenses relating to any trial or appeal (including, without limitation, paralegal fees) or arbitration or bankruptcy proceeding from the non-prevailing Party.

12. **Severability.** If any of the provisions of this Assignment or any section or subsection of this Assignment shall be held invalid for any reason, the remainder of this Assignment or any such section or subsection will not be affected thereby and will remain in full force and effect in accordance with its terms.

**IN WITNESS WHEREOF**, the Parties have caused this Assignment to be executed as of the day and year first above written.

**THE "FRANCHISEE":**

By: \_\_\_\_\_

Name: \_\_\_\_\_

Date: \_\_\_\_\_

**THE "FRANCHISOR":**

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

The Lessor hereby consents, agrees with, approves of and joins in with this COLLATERAL ASSIGNMENT AND ASSUMPTION OF LEASE.

**THE "LESSOR":**

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

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