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THE OTHER CONTRACTS IN THE FRANCHISE RELATIONSHIP

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I. SCOPE AND PURPOSE OF THE PAPER

The franchise agreement is always the most important contract between franchisor and franchisee. It contains the basic grant of the right to use the franchisor's marks and system, along with the core commercial terms of the franchise relationship. But the franchise agreement is often not the only contract governing the franchise relationship. Many franchise relationships involve other contracts between the franchisor and franchisee and contracts that the franchisor either requires or recommends that the franchisee sign with third parties. Sometimes, contracts between the franchisor and third parties also directly affect the franchisee.

This paper summarizes the function of many of these "other contracts" and explores their interplay with the franchise agreement. The coverage is, of course, not exhaustive – the list of possible "other contracts" is limited only by human ingenuity. The paper mostly excludes coverage of area development agreements, master franchise agreements, and real estate leases, all of which have been the subject of numerous past Forum workshops. Instead, the paper focuses on "other contracts" that have been overlooked as a subject of study in the past.

II. TYPES OF "OTHER CONTRACTS"

A. "Other Contracts" with the Franchisee

The first set of "other contracts" includes those to which both the franchisor and franchisee are typically parties. In some instances, they may be three-party agreements. These contracts, in turn, fall into four categories: those that precede the signing of the franchise agreement, those that are executed contemporaneously with the franchise agreement, those that may be entered into during the term of the franchise agreement, and those that may be entered into at the end of the franchise relationship. For each of these contracts, we will describe their purpose and typical provisions.

1. Contracts in the Period Before the Franchise Agreement Starts

A preliminary agreement defines the relationship between franchisor and investor before the investor actually becomes a franchisee. These short-term agreements typically merge into the franchise agreement when the franchise agreement is signed, or they expire if no franchise agreement has been signed by a certain deadline.

a. Option Agreement or Letter of Intent

An option agreement or letter of intent grants the prospective franchisee an option to acquire the franchise rights for a specific territory or location. Obviously, the option will be exercisable only if the franchisor approves the investor for a franchise. The power to exercise may also be subject to other contingencies. For example, in a registration state, one prerequisite will be that the franchisor has an effective franchise registration or exemption at the time of exercise of the option. If the option vests, the prospective franchisee will probably have only a short time in which to exercise it. The option agreement usually specifies that the option can be exercised only by signing a franchise agreement, not by a mere statement of intention to sign.

The option agreement effectively takes the option territory or location "off the market" while the franchisor and investor determine whether to sign a franchise agreement. The benefit to both parties is the reduced pressure to move too quickly with the signing of the franchise agreement. The franchisor has greater leisure to perform due diligence on the investor, and the prospective franchisee can consider the investment commitment and investigate the concept fully without worry that the desired territory will slip away. The franchisor may also benefit financially from receipt of an option fee, which may or may not be refundable. Typically, part or all of the option fee will be applied to the initial franchise fee if the franchise agreement goes forward.

b. Right of First Refusal or First Offer

A right of first refusal is less restrictive of the franchisor than an option agreement. It does not take the territory or location entirely off the market while the franchisor and investor are in discussions, but it does give the prospective franchisee an opportunity to avoid losing the desired territory or location to another party. The franchisor foregoes the option fee but retains the freedom to continue shopping the territory or location to other candidates, which protects the franchisor in case discussions with the investor do not pan out.

Rights of first refusal are notoriously difficult to draft and implement in any context, and the franchise context is no exception. It is important to specify exactly what level of activity or interest by a third party is sufficient to trigger the right of first refusal. Is it merely the submission of a franchise application naming the territory or location? Is it an internal decision by the franchisor that it would be willing to approve the third party for the franchise? In contrast to, for example, the sale of a business, in which a written purchase offer or letter of intent is an accepted standard to trigger a right of first refusal, there is no particular standard for the triggering event in the context of granting a franchise.

Another common difficulty with rights of first refusal is determining exactly what terms the right-holder must match in order to validly exercise the right. This issue may be simpler in the context of a franchise grant than in the sale of a business, where the seller's negotiations with prospective buyers may take different directions. In the franchise context, presumably the same or similar UFOC and franchise agreement have been presented to both parties. But it is certainly possible, especially in an international franchise transaction, that the franchisor will have negotiated proposed contract changes with the third party (such as the franchise fee, transfer restrictions, exceptions to noncompete obligations, etc.). The right of first refusal should address whether the right-holder is entitled to receive (and/or is obligated to match) the terms negotiated with the third party. Similarly, the right of first refusal should specify whether the two proposals must cover exactly the same territory or how to determine comparability of specific locations.

A right of first offer places more affirmative burdens on the franchisor than a right of first refusal, but is still less restrictive than an option. Under a right of first offer, the investor has no "call" on the designated territory or location like the investor has with an option. The franchisor remains free not to develop the territory at all. But if the franchisor decides to franchise the territory, the franchisor must offer the franchise to the right holder before shopping it to any other party (by contrast, under a right of first refusal, the franchisor need not offer the investor anything unless and until a third party has expressed some level of interest in the territory). The right of first offer avoids some of the implementation problems of a right of first refusal, in particular the "matching" problem described in the previous paragraph. The actual triggering event for the right may also be easier to define, because it will be tied to actions of the franchisor rather than to those of a third party. In some instances, an agreement may contain both a right of first refusal and a right of first offer.

The franchisor may decide to except itself from the right of first refusal or right of first offer. That is, the agreement may be drafted so that a decision to establish a company-owned operation (or perhaps even to issue a franchise to an affiliate) does not trigger the investor's right of first refusal or right of first offer. This exception gives the franchisor more flexibility but is less attractive to the investor because the desired territory or location is not entirely taken "off the market."

c. <u>Training Agreement</u>

Franchise agreements often contain a kick-out provision that permits the franchisor to terminate the contract if the franchisee performs poorly in training. A less common approach to the same objective is a preliminary agreement under which the prospective franchisee attends training before the franchise is ever issued. Under the training agreement, the franchisor commits to enter into the franchise agreement if and only if the prospective franchisee meets objective criteria or performs to the franchisor's subjective satisfaction in training. Meanwhile, the prospective franchisee binds himself or herself to strict confidentiality as to all information and materials imparted in training.

A key advantage of this preliminary agreement to the franchisor is that candidates who flop in training need not be counted as "terminated" franchises and as "former franchisees," as those terms are used in the UFOC Guidelines. The reason is that they never in fact become franchisees. However, the general materiality standards for UFOC disclosure may compel the franchisor to say something in the UFOC about the proportion of trainees who fall short of becoming franchisees.

A training agreement approach may be particularly useful where the business involves a very high level of specific personal skills and, thus, a high proportion of candidates who will not ultimately qualify for a franchise. For example, if the franchised business is one in which the individual would have to demonstrate dance or yoga techniques to a fitness class, to interact with small children in a preschool setting, or to teach academic subjects in a supplemental educational services program, few trainees may display the qualities necessary for success. On the other hand, a disadvantage of the training agreement approach is the risk of exposing the franchisor's "crown jewels" before the trainee has bound himself or herself to the full panoply of intellectual property and noncompete protections written into the franchise agreement. To ameliorate this situation, the training agreement may include appropriate non-disclosure and noncompete provisions.

d. <u>Asset Purchase Agreement for Company-Owned Unit</u>

Franchisors who have a regular program of spinning off company-owned units for operation as a franchise will likely have a standard purchase agreement for the prospective franchisee/buyer to sign. For uncomplicated purchase transactions, the parties may forego extensive negotiations over the purchase agreement and may sign and close at the same time, in which case the purchase agreement and franchise agreement will likely be signed contemporaneously. But if the business assets are complex and/or the purchase price is substantial, the franchisor and investor may sign a negotiated purchase agreement subject to financing, environmental review, lease assignment and other closing contingencies. In the latter situation, the franchise agreement will be signed down the road at the closing, only if the other contingencies are satisfied. If the transaction fails to close, the prospective buyer never signs the franchise agreement and never becomes a franchisee.

2. Contracts Contemporaneous with the Franchise Agreement

This section describes some types of contracts that are typically entered into at the same time the franchise agreement is signed. As indicated in the following discussion, these contracts may be attached to and incorporated into the Franchise Agreement by reference, or they may be separate contracts that are only related to the franchise agreement by cross-default provisions, or by coterminous ending dates.

a. Personal Guaranty

If the franchisee is a sole proprietorship or the franchisee consists of multiple individuals or general partners and all individual owners and partners execute the franchise agreement as "Franchisees," then each such individual is liable for performance, including financial performance, of the obligations of the franchisee. Under most states' laws, the assets of each individual signer will be available to satisfy defaults by the franchisee. However, where individual signers reside or hold property in community property states, the spouse's share of any assets may not be reachable. In addition, limited partners in limited partnerships, members of limited liability companies, and shareholders in corporations are not personally liable for the obligations of the franchisee under the franchise agreement. Further complicating this situation from the franchisor's point of view is that the franchisee is often a single-purpose entity, with the franchised location being its only asset or its major asset.

One way to better secure the franchisee's obligations to the franchisor is to have all persons (whether individuals or business entities) owning an interest in the franchise execute an unconditional general guaranty of the franchisee's obligations. Many franchisors require that any individual or entity owning or controlling a significant percentage of the franchisee entity (and their spouses, if appropriate) execute such a guaranty. Some franchisors require that all owners, regardless of percentage of ownership, execute a guaranty. Such guarantees typically provide that the franchisor is not obligated to notify the guarantors of any extension or renewal of the franchise agreement or of any default or accommodation. They also typically address choice of law, choice of forum, and waiver of objections to personal jurisdiction, either by cross-reference to the franchise agreement or by setting out provisions consistent with the franchise agreement.[1]

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[1] For more on personal guarantees, see David W. Koch, Jan M. Davidson & W. Andrew Scott, "Personal Exposure: Risk Management in the Franchise Relationship," AMERICAN BAR ASSN 22ND ANNUAL FORUM ON FRANCHISING (1999).

Individuals may, of course, attempt to negotiate out of the requirement of a personal guaranty (perhaps by offering some other form of security) or negotiate a limit to its scope or to their dollar exposure. The personal guaranties are executed contemporaneously with the franchise agreement, but usually not incorporated by reference into the franchise agreement.

b. **<u>Site Selection Addendum</u>**

The franchisor may decide to use a site selection addendum if the location of the franchise is not known when the franchise agreement is signed (which will depend on the timing of the franchisor's signing process) or if the site selection process for the franchisor's concept is complex and would weigh down the franchise agreement. The site selection addendum, while a separate executed document, is often incorporated by reference into the franchise agreement. The site selection addendum may simply designate the approved site, together with a description of the site and any conditions applicable to the site. Alternatively, the site selection addendum may contain more elaborate terms as to the criteria for selecting the site, the data that the franchisee must present for consideration of a proposed site, the mechanism for franchisor approval, steps to secure control of the site after approval, and/or financing and construction, along with deadlines for accomplishing site selection.

c. **<u>Alternative/Temporary Location Addendum</u>**

In addition to the site selection addendum, there may be a need to designate an alternative or temporary site. This circumstance arises when construction or renovation of the permanent site is expected to require an unusual length of time and it is feasible to operate the franchised business in an alternative or temporary location. The alternative/temporary site addendum will designate the alternative or temporary site, set forth any requirements for renovation/trade dress required to permit its operation as a franchised location, and set deadlines for moving to the permanent site.

d. **<u>Technology Agreements</u>**

Depending on the nature of the franchise concept, technology may play a central role in the operation of the franchised business, either because proprietary technology is part of the services provided to the public (examples might include education, training or consulting businesses) or because it is crucial to the management of the franchised business (for example, point of sale systems in retail outlets) and reporting of results (either internally or back to the franchisor). "Other contracts" between the franchisor and franchisee related to technology may involve a mere agreement to specifications of hardware and software to be purchased by the franchisee, or they may involve the sale, lease and/or licensing or sublicensing of hardware and software to the franchisee. The more complex these arrangements, the more likely they are to be contained in a separate but contemporaneous contract or license.

In addition, there is virtually no franchised business concept today that does not involve Internet advertising, website design and operation for accessibility by customers, and use of intranet or similar technology as a communication vehicle in the franchise relationship. These issues may also be the subject of separate contracts between the franchisor and franchisee.

i. Computer System Contracts and Licenses

Franchisors commonly require the use of specific computerized systems in the operation of the franchised business. Depending on the nature of the business concept, these systems may be simple or complex. For example, in a retail merchandise setting, the franchisor may require only a specified point-of-sale system to accurately record sales and produce reports in a common format for transmittal to the franchisor, or the franchisor may require a system that records sales, tracks inventory, automatically reports sales or other information to the franchisor electronically (or gives the franchisor electronic access to the information). In the hospitality industry, there may be multiple systems or an integrated package of systems related to property management, reservations, management, and reporting. Some may involve services contracts rather than licenses. Because computer systems are typically important to the business and may involve significant cost, the UFOC Guidelines require specific disclosures about them to prospective franchisees (see Section IV below).

When the required systems are the property of third parties, the franchisor may simply specify the products to be acquired by the franchisee or may purchase the systems from the third party and resell them to the franchisee. In the former case, the franchisee will be entering into related software and hardware licenses directly with the seller. In the latter case, the franchisee will enter into a sublicense agreement with the franchisor. Similarly, if the computer systems are the proprietary property of the franchisor or an affiliate of the franchisor, the franchisor will require a software license with the franchisee.

A typical software or hardware license contains a description of the nature and purpose of the software and hardware, recites the franchisor's ownership interest in the hardware or software intellectual property (copyrights, trademarks and patents), grants the franchisee a license to utilize the intellectual property for a specified period of time, reserves ownership of copyrights, trademarks and patents to the franchisor, sets forth an initial fee and an ongoing maintenance and support fee, and outlines the termination provisions. It will almost always contain a cross-default provision, or at least a provision that it ends with the termination of the franchise agreement, so that the permission to use the proprietary system ends with the end of the franchise relationship. Ideally, it will contain choice of law, choice of forum, and dispute resolution provisions that parallel those in the franchise agreement. It should either be encompassed within the terms of the personal guaranty of the franchise agreement or have a personal guaranty of a similar nature from the same parties.

Services agreements between the franchisor and franchisee may be used in instances in which the franchisee is receiving the benefit of a technology without having to host the technology at its site. An example of this type of agreement is a reservation services agreement in the travel industry, in which a franchisee pays a per-reservation fee, a monthly flat fee, or a percentage-of-revenue fee to receive reservations from a computerized reservation system operated by the franchisor or an affiliate of the franchisor. As with technology licenses, these agreements usually contain a form of cross-default provision, or at least a provision that it ends with the termination of the franchise agreement; will contain choice of law, choice of forum, and dispute resolution provisions that parallel those in the franchise agreement; and will either be encompassed within the terms of the personal guaranty of the franchise agreement or have a similar personal guaranty from the same parties.

ii. Franchisee Intranet Terms of Use

Franchise systems frequently provide intranet sites as devices for communication with and among franchisees. The sites are not available to the general public, but are restricted to those granted specific access. In order to be given access to such sites, the franchisee may be asked to sign (or click through) an agreement or terms of use.

The terms of use should specify whether and how the franchise owner may permit access by his or her employees. Because the site will likely be used for posting manuals, policies and procedures, online training modules, and other material proprietary to the franchise system, as well as for e-mail or other messaging among participants, the terms will typically contain confidentiality provisions and privacy protections, in addition to any protocols regarding what kind of information will be made available by the franchisor at the site and what kind of information can be communicated through it by franchisees, if such communication is permitted. The agreement may also include a disclaimer and limitation of liability by the franchisor as to errors, omissions, continuous operation of the site, and messages or information posted in franchisee forums. In addition, the franchisor might reserve the right to suspend the franchisee's access if he or she is in default of the franchise agreement.

iii. Franchisee Website Terms and Standards

Websites providing information to customers and the general public may be subject to different restrictions. The franchisor has an interest in regulating the presentation and use of franchisee websites for several reasons, the primary one being that a franchisee website will almost always be displaying the franchisor's trademarks. The franchisor may also be interested in assuring that franchisee websites are consistent with exercising the rights granted to the franchisee while not infringing on the rights granted another franchisee, such as those related to protected territories or identified distribution channels. For these reasons, franchisors may place restrictions on the form, content, location, and links from these sites. A franchisor may do this by limiting websites to those hosted by the franchisor or as pages on the franchisor website, in which case the franchisor would typically place such a restriction in the franchise agreement (or as a separate requirement in the operations manual) and enter into a web-hosting agreement with the franchisee or designate a vendor to host approved websites.

In the alternative, the franchisor might merely specify the standards for a public website and require that the franchisee enter into an agreement to abide by them in return for permission to operate the site. Typical standards include overall look and feel consistent with general advertising of the franchisor's marks, services and products; descriptions of products and services, as well as terms of offer (including locations) consistent with the franchise agreement and general franchisor standards; links of the site only to and from approved sites (for instance, in industries providing centralized reservation services, there may be a requirement that any link for reservations be to the centralized reservation system); compliance with laws related to e-mail communication and privacy; and franchisor review and approval of the site before it goes live.

e. Construction/Renovation Contract with Scope Of Work and Time Commitments

When the operation of the franchised business involves the franchisee constructing or renovating a retail location or outlet or other physical structure at which products and services are delivered, the franchisor and franchisee will often enter into a separate agreement related to the standards for, timing of, and terms and conditions applicable to the construction of the facility to franchisor standards or the renovation of an existing facility to franchisor standards. Where new construction is required, the agreement will typically require use of approved plans consistent with a prototype building built to suit the location; establish the procedure for varying from the standards; set a specific timetable for construction with checkpoints along the way; make the franchisee responsible compliance with applicable building codes, ADA requirements, and other laws; require use of approved materials, furniture, fixtures and equipment; and contain a provision that failure to meet the deadlines in the agreement will entitle the franchisor to terminate the franchise agreement. The construction schedule and deadlines in these agreements must be reconciled with any required opening date specified in the franchise agreement. Delays in construction may necessitate an amendment to the franchise agreement, extending the opening date.

A renovation project may take a broader range of forms. In its simplest form, a renovation agreement will specify the minimum requirements for trade dress—color schemes, required signs, design of reception areas/customer service desks---with considerable latitude to the franchisee. It will likely require franchisor approval of plans and approval of the final result and may or may not require that all work be completed prior to operating under the franchisor's trademarks. Such simple renovation projects may involve small storefront operations or office environments. In more complicated forms, a renovation project may involve a detailed scope of work or property improvement plan, including timetables and checkpoints; adherence with franchisor standards and use of approved materials, furniture, fixtures and equipment; franchisee responsibility for compliance with applicable building codes, ADA requirements and other laws; provision for franchisor inspection of various completion milestones; a clear understanding of whether the franchised business may operate at the location during the renovation: and, as with the new construction agreement, a provision that failure to meet the milestones will entitle the franchisor to terminate the franchise agreement and a reconciliation of renovation completion dates with any required opening date in the franchise agreement. These types of agreements are common when renovating a stand-alone structure, such as a restaurant or a hotel, converting it from one brand to another.

f. Collateral Agreements and Contingent Assignments

i. Leases

In franchise concepts with retail outlets or other locations that provide customer contact, and in which the franchisor is not the owner of the property, the franchisee may lease the location and/or fixtures or equipment from a third party. If continuity of control of the location is important to the franchise system, then the franchisor may require a contingent assignment or pledge (collateral assignment) of the leases to the franchisor in the event of a termination of the franchise agreement. To assure that such an assignment or pledge is effective, the franchisor will need to review the terms of the underlying leases and, if necessary, require the franchisee to negotiate into the leases the required language to permit the contingent assignment or pledge. Such provisions usually include notice to the franchisor of any default in the lease by the franchisee, so that the franchisor may take steps (including terminating the franchise and/or exercising its rights under the contingent assignment) to protect the location. The franchisor should also assure that the assignment agreement itself gives the franchisor the right to terminate the franchise agreement in the event of a default in the leases that triggers the effectiveness of the assignment (a form of cross-default provision).

ii. <u>Telephone Numbers</u>

It is common in the franchise relationship for the franchisor to require contingent assignment of ownership in phone numbers used in the franchised business in the event of expiration or termination of the franchise agreement. The rationale and legal justification for the requirement is two-fold: that the advertising of the telephone number in conjunction with the trademarks of the franchisor and the franchise concept creates good will in the phone number associated with the mark (which, by definition under the franchise agreement, all belongs to the franchisor), and that the long lead times for changing telephone directory listings and other listings of franchised locations creates the potential for confusion of customers or unlicensed use or profit from the marks.

The franchise agreement typically contains a provision that the franchisee agrees to such an assignment in the event of expiration or termination, but it makes the process go more smoothly at that time if the franchisee signs the assignment document up front. Such assignment agreements will specify the telephone numbers to be assigned, the circumstances under which the assignment becomes effective, allocation of costs of maintaining the rights to the phone number after the effective date of the assignment, and an agreement of the franchisee to execute any additional third-party forms that may be necessary to effect the assignment. Where possible, the third-party form should be attached, with the effective date left blank. The utility of such pre-signed forms is not certain, since the passage of time between the date of the assignment agreement (contemporaneous with the franchise agreement signing) and the termination may be years, with the result that the name of the telephone company may have changed in the interim or the required form may have been revised.

g. <u>Supply Agreement</u>

Many franchise concepts involve use or sale of approved products, often proprietary or branded products of the franchisor. The terms on which the franchisor or an affiliate sells or otherwise makes products available to franchisees may be contained in the body of the franchise agreement. Often, however, such terms are contained in a separate supply (or purchase) agreement. Such agreements may contain product descriptions and specifications, particularly when the supplier is a third party; required purchase (or supply) volumes; exclusivity provisions; prices or methods of determining prices from time to time; shipping and delivery provisions; and other terms and conditions typical for supply or purchasing contracts. In another form, a supply (or purchase) agreement may make available to the franchisee access to a purchasing program or system operated by the franchisor or an affiliate for products and services other than the proprietary or branded products covered by the first type of supply agreement described above. We discuss this variant in Section II.B, in the context of franchisor-prescribed agreements with third parties.

h. Financing Documents and Security Agreements (with or without financing)

A franchisor that finances all or part of the start-up costs of the franchise will require a promissory note and related security agreement or security agreements. The franchisor will typically require purchase money security interests in specific equipment and goods purchased with loaned funds and security interests (and recordable liens or mortgages) on real property, along with a recordable security interest in all the property of the franchisee, including the franchisee's interest in the franchise agreement, accounts receivable, and intangibles. The franchisor may also require pledges of personal assets of the owner/guarantors, along with a security agreement securing those pledges. Even in circumstances in which the franchisor does not provide up-front financing, the franchisor may require a security interest in accounts receivable and in the franchise agreement itself. One reason for such a requirement is Revised Article 9 of the Uniform Commercial Code, which disregards anti-assignment clauses in franchise agreements.[2] The requirement of a security interest helps protect the franchisor's priority in the event of bankruptcy of the franchisee.

The forms of promissory note, pledge, and security agreement (except for real property liens or mortgages), can generally be comprehensive generic forms that will be effective in all states. To perfect the security interest in property covered by the security agreement in property other than real property, the franchisor will need to make UCC filings in the appropriate jurisdictions. Mortgages, deeds of trust or other lien documents related to real property must conform to individual state laws and procedures to be effective.

i. Leases from Franchisor (Real Estate or Equipment)

Control of real estate by the franchisor is a cornerstone of some franchise systems. In such systems, the franchisor either owns the locations or leases them from third parties and then leases, or sub-leases, them to a franchisee for a term coterminous with the franchise agreement. This gives the franchisor the ability to assure a consistent presence of its outlets at preferred locations. Terms of such leases or subleases are typical of standard leases for such locations and their fixtures, except that they typically contain cross-default provisions with the franchise agreement and may also contain specific requirements to keep the trade dress up-to-date with system standards at franchisee expense. Franchisors will typically require guarantees of such leases by the same persons who guarantee of the franchise agreement.

Where the franchisee is required to obtain specified equipment in order to provide services to customers under the franchise agreement, the franchisor or an affiliate of the franchisor may acquire such equipment and lease it to the franchisee. This may consist of equipment not considered fixtures under a real estate lease or it may be equipment, such as required ice cream machines or ovens, used to prepare products sold to the customer. It may also include equipment rented to customers as part of the

[2] U.C.C. § 9-408(a).

franchise concept---everything from carpet cleaners to automobiles. Terms of such leases will be typical for the type of equipment, but with cross-default provisions with the franchise agreement and, perhaps, personal guarantees.

3. "Other Contracts" with the Franchisee Arising in the Course of the Relationship

Sometimes specific events occur in the life of the franchise relationship that, as a matter of necessity or convenience, create the need for a specific set of terms or rules to address the situation. In some cases the triggering event is expressly foreseen in the franchise agreement, though its occurrence or the timing of the occurrence is not certain. Rather than load up the franchise agreement with provisions that may never come into play (and that may become outdated by the time the event occurs), the franchisor may choose to leave implementation to a separate agreement to be signed later. In other cases the event may be one that the franchise agreement did not contemplate, and a separate agreement is therefore needed to deal with the unforeseen circumstances.

a. Marketing Co-op Agreement

Many franchise agreements reserve to the franchisor the right to compel franchisees to form or join a regional or local advertising cooperative. Even if the franchise agreement is silent, franchisees may wish to join together voluntarily for ongoing advertising or marketing efforts. A marketing co-op agreement is one means of structuring a co-op, whether mandatory or voluntary.

The marketing co-op agreement functions like the articles and bylaws of a corporation or the operating agreement of a limited liability company. The members could, of course, take the more formal step of incorporating or forming an LLC, but the franchisor may decide that that step is unnecessary, especially if the co-op agreement can legitimately apply the law of a state (such as Delaware) that has adopted the Uniform Unincorporated Nonprofit Association Act.[3]

The co-op agreement defines the purpose, geographic scope and powers of the cooperative, sets the rules for membership and for contributions and expenditures, and establishes the governance structure (meetings, officers, voting, decisions reserved to the full membership, etc), all subject to any parameters laid down in the franchise agreement. Because additional members might join the co-op later, it is convenient to create a short joinder form by which they can subscribe to the agreement. The franchisor should retain the right to approve changes in the co-op agreement and the right to require the co-op to change its legal form.

It is probably desirable as well to specify, at least in broad form, the procedure for planning and approval of the co-op's actual advertising and marketing activities (e.g., the agreement might require adoption of a quarterly plan by vote of the membership, subject to approval by the franchisor, with the plan to be carried out by the co-op officers). The franchisor should assure that it retains the right to specify how its trademarks will be used in such advertising and marketing. The co-op agreement should

[3] UNIFORM UNINCORPORATED NONPROFIT ASSOCIATION ACT (NAT'L CONF. OF COMMISSIONERS ON UNIFORM STATE LAWS 1996). Twelve states have adopted the UUNAA.

also specify the financial or other assistance, if any, that the franchisor is obligated to provide to the co-op, including whether the franchisor must contribute for corporate-owned locations in the same manner franchisees do for their locations.

b. National Account Participation Agreement

Franchisors began using participation agreements for national account arrangements out of concern for resale price maintenance restrictions under the antitrust laws. When all forms of resale price maintenance were *per se* illegal, franchisors could not force franchisees to honor national account prices without undue risk. One solution was an agreement demonstrating that the franchisee's participation in the national account program was voluntary, not coerced.

In 1997, the Supreme Court changed the law in *State Oil Co. v. Khan*,[4] so that *maximum* resale prices were no longer *per se* illegal but rather subject to the "rule of reason," under which the practice violates federal antitrust law only if it has a net anticompetitive effect based on all of the facts and circumstances. This change reduced the risk to franchisors of mandating participation in national account programs that set a maximum price to be charged to the customer. Still, some franchisors continue to use participation agreements, because: (a) the franchise agreement makes participation voluntary for the franchisee as a contractual matter; (b) the franchise agreement is silent as to national accounts; or (c) the franchisor simply likes the approach better as a business matter.

c. Forbearance (Workout) Agreement

"Forbearance" is a term borrowed from commercial lending to refer to circumstances in which the franchisor has the right to terminate the franchise agreement for an uncontested monetary default but agrees to forbear from that action in exchange for concessions from the franchisee. The forbearance (or workout) agreement recites the default (basically constituting an admission of breach by the franchisee), the franchisor's agreement to rescind (or to refrain from issuing) the notice of termination for that particular default, a payment plan for the debt (perhaps financed by the franchisor through a secured promissory note, but perhaps also including some forgiveness), and the specific concessions made by the franchisee (possibly including accelerated default/termination for future defaults). The agreement will likely include a release of claims from the franchisee and might incorporate revised dispute resolution provisions from those in the franchise agreement.

d. Test Agreement

Franchise concepts naturally evolve in response to changes in consumer tastes, demographics, competition, technology, and laws. Franchisors may use company-owned units as test labs for new products, services, equipment, and methods of operation. But some franchisors do not have company-owned units, and even those that do may want a trial implementation with a few franchisees before rolling out a change to the entire system.

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[4] 522 U.S. 3 (1997).

A test agreement may come in handy in these circumstances, especially with respect to a new product or service, a co-branding idea, or a new type of business location. The test agreement will invariably have two characteristics: it will be a short-term agreement and it will have specific criteria or a mechanism to determine whether the test is "successful." The short term agreement lowers the business risk for each party, because neither is locked in if the new item or location doesn't win market acceptance or has unforeseen consequences. Putting the test terms in a separate agreement avoids burdening the existing franchise agreement – the additional terms can come and go without affecting the underlying agreement. At the same time, the test agreement can piggy-back on provisions of the franchise agreement by cross-reference where appropriate.

Other specifics of the test agreement will be tailored to the thing being tested and might be quite creative. For example, if the test involves a substantial cost to the franchisee, the franchisor might subsidize it or agree to reimburse if the test is not successful. A new product or service might be exempt from royalties during the test period. A "successful" test might obligate the franchisor to offer the new item to the system and cause the test agreement to become a permanent part of the franchise agreement, or it might only give one or both parties an option. Various permutations are possible; the approach chosen may depend on whether "success" is a subjective determination by the franchisor or an objective determination based on verifiable data.

e. Management Agreement

A management agreement authorizes the franchisor to operate the franchised business on behalf of the franchisee. Although a franchise relationship usually requires the franchisee to own and operate the franchised location(s), there may be situations in which it is to the advantage of both the franchisor and franchisee for the franchisor to manage the franchised location, either on a temporary basis or for an extended term. The franchise agreement may expressly contemplate situations that call for a short-term management agreement (*e.g.*, pending disposition of the franchise after the death or incapacity of the principal owner or other transition period from one owner to another; management for a period of time during training of franchisee employees or expansion of the franchise holdings of the franchisee from a single unit to a multi-unit owner; management by the franchisor as a remedial measure for a troubled franchise). But a management agreement might also be useful in unusual and unforeseen circumstances (*e.g.*, the franchisee's spouse is transferred overseas for a year).

Long-term management agreements between franchisor and franchisee are not typical in franchising, except in the mid- to upscale hotel brands, where many franchisees have more of an "investor" than an "operator" profile. In many instances, such hotels are not involved in franchises at all, but are purely manager/owner relationships.

In the franchise context, the management agreement appoints the franchisor to run the franchised business in exchange for specified compensation, which is in addition to the royalty and other fees collected under the franchise agreement. It should give the franchisor/manager access to the receipts of the business in order to pay the expenses of the business, including franchise agreement charges, subject to regular accounting to the franchisee/owner. It probably will require the manager to get approval of an operating budget and specific approval for capital expenditures and expenditures over a certain amount. The manager will likely staff the franchise with its own employees in order to give the manager greater control, though the manager may hire the franchisee's personnel for this purpose in a short-term arrangement. The manager will likely be expected to indemnify the owner and perhaps even to fund a performance escrow. On the other hand, the manager might try to negotiate an option to buy the business assets as part of the management agreement.

Where a franchisor enters into such arrangements, it is critical to separate the manager/owner relationship from the franchisor/franchisee relationship by entering into a separate management agreement between the franchisor (or an affiliate of the franchisor) and the franchisee. Nothing about the existence of the management agreement should alter the underlying franchisor/franchisee relationship; rather the management agreement should treat the franchisor as if it were an unrelated third party.

The management agreement should allocate responsibility between the manager and the franchisee in the following areas: supervising construction and/or renovation before opening; pre-opening planning and budgeting; pre-opening ordering and installation of equipment and furnishings; day-to-day management of the franchise business; licensing and permits; paying the bills; maintaining bank accounts; budgeting for future years; hiring and firing employees; repairs and maintenance; capital improvement budgeting; reporting and recordkeeping. The management agreement should set out the basis on which the manager will be compensated for its services and the term and termination provisions for the arrangement, particularly how a termination of the management agreement affects the franchise agreement and vice versa. A carefully prepared management agreement can preserve the limitation of liability of the franchisor *qua* franchisor, while defining the relative liabilities of the franchisee and the franchisor *qua* manager.

4. "Other Contracts" with the Franchisee at the End of the Relationship

Almost every franchise agreement provides for its own end in two ways: by expiration of its stated term and by termination due to breach. Those are not, of course, the only ways in which the franchise relationship can come to an end. In this section we describe two "other contracts" that the franchisor and franchisee might use to end their relationship in other situations.

a. Consent to Transfer

In the event of a transfer of a franchise from one owner to another, a franchisor may enter into an agreement outlining the terms of its consent to the transfer. Such agreements may include only the franchisor, franchisee and guarantors, or, depending on the scope of the agreement, may also include the transferee and the new guarantors. Included among its provisions may be: (1) acknowledgement of receipt of the UFOC from the franchisor (because franchisors typically require the new franchisee to enter into a "then-current" form of franchise agreement, rather than merely taking assignment of the old one); (2) setting the date upon which responsibility for performance of the franchisee transfers to the new franchisee; (3) stating whether the term of the "transferred" franchise agreement is a new term or the balance of the term of the old franchise agreement; (4) setting out payments that are due to the franchisor before the transfer is completed (or at closing), including any transfer fee; (5) releases of liability and the conditions for such releases being effective; (6) indemnities or acknowledgement of the continuation of indemnities, as appropriate; and (7) acceptance of responsibility by the new franchisee and its guarantors for entering into the new franchise agreement (and executing related guarantees) as a condition of franchisor's consent. Where the consent to transfer is only a two-party agreement between the franchisor and existing franchisee, it may be combined with a mutual termination agreement.

b. Mutual Termination Agreement

A mutual termination agreement is an agreement to terminate the franchise agreement before its intended expiration date. The parties to a mutual termination agreement will typically be the franchisor, the franchisee and the guarantors, although the terms of most franchise-related guarantees include a provision that the franchisor and franchisee may compromise matters without notice to or agreement of the guarantor. Common uses of mutual termination agreements include those situations in which the parties agree to a compromise of outstanding defaults rather than terminate for cause, or those situations in which the franchise agreement does not specifically permit a franchisee to terminate the agreement, other than for cause, but the parties agree that the franchisee will be permitted to terminate voluntarily. As with a consent to transfer, the mutual termination agreement may contain: (1) provisions setting the date upon which responsibility for performance of the franchisee under the franchise agreement ends; (2) provisions setting out payments that are due to the franchisor before the termination date and the method and timing for determining and paying any amounts that may become due after the termination date; (3) releases of liability and the conditions for such releases being effective; (4) indemnities or acknowledgement of the continuation of indemnities, as appropriate; and (5) de-identification responsibilities and deadlines.

B. Franchisor-Prescribed "Other Contracts" between Franchisee and a Third Party

All of the "other contracts" discussed to this point are agreements between franchisor and franchisee. Some of the "other contracts" that form part of the franchise relationship are not between those parties – rather, they are agreements between the franchisee and a third party. We describe some important examples below.

1. Individual Confidentiality/Noncompete Agreement

Franchise agreements always impose confidentiality and noncompete obligations on the named franchisee, but binding the franchisee alone -- whether the franchisee is an individual or a legal entity – may be insufficient to protect the franchisor's interests. Because confidentiality and noncompete covenants tend to be construed literally and strictly construed, the covenants might leave the franchisor at risk if only the named franchisee were bound. Accordingly, the franchisor usually will reserve the right to require that the franchisee obtain signed agreements from individual owners of the business and/or management-level employees in which those additional individuals bind themselves personally to confidentiality and noncompete obligations.

For individuals who will serve as a guarantor of the franchisee's obligations, these covenants can be built directly into the personal guaranty, but for non-guarantors a separate agreement will be needed. Some franchisors provide a form agreement while others simply state in the franchise contract that the individual agreements must be in a form acceptable to the franchisor. Creating a form agreement costs the franchisor more trouble and expense up front, but may be cheaper in the long run.

The form agreement should lay out its purpose in plain English. This is for the benefit of the individual who is signing as well as the added protection of the franchisor. Here's an example: "We operate our business under a Franchise Agreement with XYZ Company. XYZ recognizes that, in order to operate our franchise effectively, we must give our employees access to certain confidential information and trade secrets owned by XYZ or its affiliates. Disclosure of this confidential information and trade secrets to unauthorized persons, or its use for any purpose other than the operation of our franchise, would harm us, XYZ, and other franchisees of XYZ. Accordingly, XYZ requires us to have you sign this Agreement."

The form agreement should state the franchisor's right to enforce the agreement directly against the individual. If noncompete provisions seem inappropriate for the person signing the agreement, the agreement can be limited to confidentiality only. Either way, it should be set up so that the agreement continues until the end of the person's association with the franchisee, and any "post-term" obligations should be keyed to that event.

2. Customer Contracts

Most franchised businesses involve relatively simple buyer-seller transactions between the franchisee and his or her customers. Some franchise concepts, however, involve more complex transactions with customers (such as custom-designed home storage systems), riskier activities (such as fitness classes), and/or an ongoing relationship (such as business coaching). In these franchise networks, one of the "other contracts" might be a customer contract that the franchisor makes available to franchisees or requires them to use.

The franchisor has an economic interest in helping franchisees protect themselves from customer claims that might disrupt the franchised business, damage the brand, or even cut into the royalty stream. These concerns might, for example, prompt a fitness concept franchisor to require franchisees to have customers sign a standard liability waiver.

The franchisor also has an interest in promoting consistent treatment of customers. Disparate terms at different franchises may lead to unreasonable customer expectations, which may lead to disappointed expectations, which may lead to claims. For example, suppose some franchises in the network offered a ten-year warranty covering parts and labor, while others offered a three-year warranty covering parts only.

Prescribing customer contracts also gives the franchisor an opportunity to educate consumers that they are dealing with a franchised outlet, not with the franchisor. To take advantage of this opportunity, the franchisor must avoid a common mistake – handing the franchisee a photocopy of the customer contract from a company-owned unit, without bothering to strike out the franchisor's name as the contracting party and replace it with the franchisee's name.

3. Vendor Contracts

We discussed supply agreements in Section II.A.2.g above, in the context of "other contracts" between the franchisor and the franchisee. Alternatively, the franchisor might develop a supply agreement (or participation agreement) for the franchisee to sign with one or more third-party vendors. This is especially likely in situations where the franchisor has set up a formal purchasing program or system with external vendors. Such agreements give franchisees the benefit of volume buying from approved suppliers and will typically describe (perhaps by reference to a master agreement between the franchisor and supplier) methods and terms of access, terms of payment and shipping, and related points mentioned in Section II.A.2.g. The franchisee may have an obligation to obtain some or all of its requirements of the product or service via the purchasing program, a provision that is designed to support the franchisor's ability to negotiate favorable terms and possible exclusivity with the supplier based on system-wide volume. To protect the supplier against transshipment, the franchisee may be prohibited from reselling or redistributing the products except to end users through the franchised business.

C. "Other Contracts" Between Franchisor and Third Parties that Directly Affect Franchisee(s)

We believe there is a third category of "other contracts" that merits discussion in this paper – specifically, agreements which the franchisor signs with parties other than the franchisee. While not, strictly speaking, part of the "franchise relationship" in the sense that the franchisee does not sign them, these other contracts directly affect the relationship between the franchisor and the franchisee.

1. IP License or Services Contract

The franchisor is not always the owner of the trademarks and other intellectual property associated with the franchise concept. Often, an affiliate of the franchisor is the legal owner of the property. This may result from historical development – in particular, from a decision by the brand owner, at the outset of its franchise program, to create a subsidiary or sister company to serve as the "franchisor." Or it may result from a restructuring driven by tax or other non-franchise considerations, such as a decision to create an intellectual property holding company in a state without a corporate income tax.

However the situation arises, it calls for an agreement between the affiliate and the franchisor authorizing the latter to use the marks (and perhaps other intellectual property) in the franchise program. The agreement must, of course, include authorization to license the marks and other intellectual property to independent franchisees.

In the authors' experience, clients in this situation sometimes neglect to adequately document the agreement between the franchisor and its affiliated owner of intellectual property. A savvy franchise investor, or his or her attorney, will surely notice this "missing link." In fact, the UFOC Guidelines are structured to highlight any such gap. The disclosure requirements and/or investors' demands for assurance of their rights to use the marks usually convince clients to write an inter-affiliate license agreement. The document can be fairly simple, with or without a royalty as suits the concept owner's financial structuring objectives. Typically the agreement has a very long term (e.g., 99 years) and narrowly-drawn circumstances in which it can be terminated early, thus assuring the franchisee that its rights are very unlikely to be interrupted.

The franchisor may also have arrangements with affiliates for things other than intellectual property. For example, a brand owner might decide to create a subsidiary to serve as franchisor but to employ few or no people at the franchisor level. Instead, the parent company or affiliate will lend its employees to the franchisor and provide many or most of the internal corporate functions that the franchisor will need. For this arrangement, the franchisor might enter into a services agreement or management agreement with the parent company. One benefit of this approach is that the agreement may give the parent company the choice of receiving income from the franchisor in the form of fees for services rather than as dividends. Franchisees will clearly have a strong interest in the agreement as well, because the franchisor's ability to honor its support commitments may depend on it.

2. <u>Comfort Letter/Estoppel Certificate</u>

Financing is another area that generates "other contracts" affecting the franchise relationship. If the franchisor offers financing directly to franchisees, the other contracts will include a promissory note and, most likely, a security agreement. For details on franchisor financing programs, we defer to other past and future Forum workshops. Instead, we focus here briefly on external financing by third parties.

A franchisee seeking financing from a commercial lender may be required to provide the lender with a comfort letter or estoppel certificate from the franchisor. The purpose of the comfort letter is to verify to the lender that the franchise agreement is in effect, not about to expire and not in default. Any of these factors affect the stability of the franchisee's business and thus the lender's risk in making the loan. Without such assurance, the lender may be unwilling to make the loan at all, or may only be willing to finance a lower amount at a higher interest rate. If it is the franchisor who seeks financing, the franchisor may have to obtain a similar comfort letter from franchisees to give the lender assurance about the franchisor's income stream from the franchises.

If the franchisee proposes to grant the lender a security interest in the franchise agreement, the franchisor might insist on an agreement with the lender that goes beyond a simple comfort letter. In that case, the franchisor might use a consent agreement that sets forth the respective rights and remedies of the franchisor and lender in the event of a default by the franchisee under either the franchise agreement or the loan documents. Ideally, the franchisor will negotiate a provision subordinating loan payments to the franchisee's obligations for royalties and other franchise fees, though in practice it is difficult to obtain this concession from lenders.

3. <u>Manufacturing License/Approved Supplier Agreement</u>

A manufacturing license is an agreement by which the franchisor engages an independent supplier to manufacture products used in the franchise system. The agreement may require the manufacturer to sell its output to the franchisor, or it may authorize the manufacturer to sell and distribute products to franchisees directly or through approved distributors. The agreement is a "license" because the franchisor, at a minimum, is authorizing the manufacturer to use the franchisor's trademark on the product. If the product is proprietary to the franchisor, then the franchisor might also be licensing a patent or trade secret (e.g., a unique recipe) to the manufacturer.

As with any license of intellectual property, the manufacturing agreement should be clear about the licensee's authorized scope of use, exclusivity (if any), and right to sublicense (if any). Making the license too broad could adversely affect franchisees by allowing the manufacturer to sell the proprietary product outside of the system. The manufacturing agreement will also include economic terms that affect franchisees – either pricing terms for purchases by the franchisor, which will be reflected in the resale price to franchisees, or possibly a commission paid to the franchisor on the manufacturer's sales of the licensed product to franchisees or intermediaries.

An approved supplier agreement plays off of an underlying franchise agreement obligation by the franchisee to purchase only from approved suppliers. It is an agreement by which the franchisor formally designates the supplier as one from whom franchisees may purchase. The designation is typically based on the franchisor's prior assessment of the supplier's capabilities as to quality, volume, and service. The agreement may or may not incorporate pricing terms negotiated by the franchisor on behalf of franchisees, but it will at least require the supplier to maintain standards of quality and service in order to retain its approved status.

4. "Recognition" Agreement

We conclude our sampling of "other contracts" with one that is rare in practice but huge in practical importance when used – namely, an agreement by which the franchisor consents to a formal role in the system by a franchise advisory council or even an independent franchisee association. Such a "recognition agreement" may have its origins in a franchise agreement provision requiring the franchisee to join a particular association or its successor. Alternatively, it might arise in the context of settlement of litigation between the franchisor and a large group of franchisees. Or the franchisor may simply decide that a recognition agreement is a good idea for its system.

There are few models extant of a recognition agreement, but some desirable features seem fairly obvious. First, the franchisor's commitment to the association should be as specific as possible. If, as is likely the case, the association will act purely in an advisory capacity, the agreement should so state. It should specify the number of regular meetings, who will attend on behalf of the franchisor, and how the franchisor and the association will allocate meeting expenses. Further, it should state whether the franchisor will provide any administrative support to the association (such as collecting membership dues on behalf of the association) and whether the franchisor will be compensated for that service.

Second, the agreement should describe the circumstances in which the franchisor can withdraw its recognition of the association (e.g., the association membership falls below some threshold percentage of franchisees in the system, the association changes its governing documents without the franchisor's consent, or the association sues the franchisor). The agreement should also clarify whether and when the franchisor is free to recognize other franchisee organizations.

Finally, as part of the deal for giving the association a formal role, the franchisor should obtain a covenant by the association not to sue the franchisor except for breach of an express term of the recognition agreement.

III. STRATEGIC CONSIDERATIONS AND CONTRACT MANAGEMENT ISSUES

A. <u>Why Use a Separate Agreement</u>?

Given the wide variety of issues covered by the separate agreements described above, and the apparent integral connection of some of them with the basic franchise relationship, a logical question is, why not include all of these provisions as options within the franchise agreement, or include the applicable provisions in a franchise agreement tailored to each franchisee?

One obvious answer is that the need for the additional contract terms may not have been foreseen. The circumstances that motivate the drafting of contract terms may not have existed when the franchisee received the UFOC and signed his or her franchise agreement. Examples among the “other contracts” discussed above include the test agreement, forbearance agreement and mutual termination agreement.

Even if the subject matter is foreseeable or routine, several factors may argue for separate agreements:

- Perhaps the particular requirement is going to be optional or the issue otherwise does not apply to all franchisees. If that is the case, why burden the franchise agreements of those to whom it doesn’t apply?

- The franchisor might have concerns (justified or not) that significant alterations to the franchise agreement based upon the circumstances of the particular franchisee would trigger additional disclosure or registration amendment requirements.

- The subject matter might involve different parties from the franchise agreement (*e.g.*, an affiliate of the franchisor rather than the franchisor itself, an outside vendor, or a guarantor), or it may involve multiple additional parties.

- The parties might want to allow for separate termination or assignment of the subject matter (*e.g.*, a software license agreement). Those actions would be unwieldy if the subject matter were incorporated into the franchise agreement rather than in a separate agreement. Moreover, the reason for termination may not constitute justification for default or termination of the entire franchise agreement.

- Circumstances may suggest application of a different state’s law or different forum from those chosen in the franchise agreement (*e.g.*, lease assignments may have to conform to local law; certain courts in a state may not have jurisdiction over certain types of disputes).

- The subject matter may have different (typically shorter) duration than the term of the franchise agreement, or the parties may desire different renewal provisions.

- The franchisor might be concerned about the marketability of the franchise agreement, in terms of its length and complexity. The franchisor might also believe that a longer and more complex franchise agreement will be harder for the franchisor's own employees to understand, implement, and enforce than a series of shorter agreements.

- The franchisor may wish to highlight the availability of a particular optional product or service by providing for it in a separate agreement.

At least two significant factors weigh against those listed above. First, the separate agreements will have to be disclosed in Item 22 of the UFOC if the franchisor uses them in connection with offering the franchise agreement, and may have to be disclosed if they are required at any later stage (see Section IV below). The "other contracts" probably will complicate the UFOC disclosures to some degree and are more likely to turn the document into a "phone book" than if they were consolidated into the franchise agreement.

Second, using "other contracts" will add significantly to the franchisor's contract management burden. The more contracts that are in use, the more documents the franchisor's staff must keep track of, increasing the chances of failing to get an agreement signed or having it get separated from the file. Similarly, document production will be more difficult and expensive in the event of a due diligence review of the franchisor's files or a discovery request in litigation.

B. Coordination with Franchise Agreement

In every franchise relationship, there is likely to be at least one "other contract" with the franchisee. In most franchise relationships, there are several. It is important for both the franchisor and franchisee to assure that each contract works in concert with the rest to ensure a smooth day-to-day working relationship and to facilitate orderly termination, in the event that becomes necessary. The following factors should be considered in drafting the separate agreements and as a checklist when finalizing the package of agreements to be executed.

1. Parties

Consideration of who are the appropriate parties is part of both the substance of the agreements and the completion of the forms for each franchise relationship. Consideration must be given to the form of organization of the franchisee to determine whether the terms and conditions of the agreements are applicable to the particular form of organization, which persons or entities should be parties to the various agreements and the manner in which they are signed. For example, if the franchisee is a partnership or limited liability company, the franchisor may require that the franchise agreement be signed by the managing partner on behalf of the partnership and then personal guarantees signed by each partner of the partnership or by the managing member on behalf of the LLC with guarantees from all members of the LLC. Or if the franchisee is structured such that one entity owns the real estate and another is the "manager" of it, care must be taken to make sure that both entities enter into the appropriate agreements or guarantees to protect the franchisor's recourse in the event of default.

2. Duration/Cross-default/Cross-termination

The interrelationship of the various types of agreements and the parties to each should be considered when defining length of term of each and any cross-default or cross-termination provisions. The objective of this reconciliation is to assure that, unless there is a particular reason why the parties would want to continue to be obligated to each other under one agreement when the others had expired or terminated or unless the agreements are by their nature short term in nature, the various agreements are coterminous. It will thus be important to reconcile the beginning and ending terms of the various agreements (including any renewal options) and to define the instances in which either the default in one agreement is a default of the others, or those instances in which the termination of one agreement is an effective termination of the others. It cannot be assumed that a notice of default of one agreement is necessarily a notice of default of the others, especially in cases in which there is not an identity of parties among the various agreements.

3. Choice of Law/Forum and Personal Jurisdiction

Each of the separate agreements should be reconciled with the others with regard to choice of applicable law, selection of a forum for resolution of disputes, and waivers of objection to personal jurisdiction.

In general, each of the various agreements will often select the same state's law to apply to its formation, execution, interpretation, enforcement and any other issue arising out of the franchise relationship. A franchisor will often select the law of its own jurisdiction to govern, helping to ensure uniform interpretation and application of the franchise agreement. Exceptions to this guideline are instances in which a particular state's law or a local ordinance may have overriding application to the agreement, as outlined above in Section III.A., or in which a particular state's franchise relationship law may limit the application of such a provision.

Similar considerations apply to selection of a forum. A franchisor may have a preference for litigating (or engaging in other forms of dispute resolution) in its home forum, both for convenience and for uniformity of application of that state's law to its agreement form. Conversely, the franchisor may as a matter of corporate strategy wish to agree to litigate (or engage in other forms of dispute resolution) in the forum in which the franchised business is located. Even in instances in which it decides that its own state's law should apply to all the agreements, a franchisor should not automatically restrict litigation to its home district and forbid the parties from litigating elsewhere. Because parties may not confer subject matter jurisdiction on a court by agreement, a franchisor may find itself with no appropriate form in which to resolve the dispute if the selected forum does not have subject matter jurisdiction of the dispute (such as a foreclosure of a lien) arising in a foreign jurisdiction. A better approach may be to select the franchisor's home jurisdiction as an appropriate forum, with a waiver of objections to personal jurisdiction in that court, or to select the franchisor's home jurisdiction as the forum unless that forum does not have subject matter jurisdiction, in which case any forum that has jurisdiction of the subject matter and the parties could be the alternative designation.

Particular attention should be placed on assuring that all parties to all agreements have appropriately waived objections to jurisdiction in the chosen forum(s).

In particular, reliance on the franchisee's waiver in the franchise agreement to act as a waiver for guarantors of the franchisee's performance under the agreement, or for affiliates of the franchisee, may be misplaced. Careful drafting and reconciliation of the terms of all related agreements can avoid situations in which a person who is a necessary party to litigation of a particular dispute cannot be brought within the jurisdiction of the court that the parties have agreed will be the exclusive forum.

4. Type and Location of Dispute Resolution

Franchisors typically give a great deal of thought to issues surrounding choice of law, choice of forum, and dispute resolution mechanisms available to the parties to the franchise agreement, but they may pay less attention to the dispute resolution mechanisms in the "other contracts." Failure to give adequate attention to these points may create enforcement difficulties in the course of the relationship. For example, if the franchise agreement requires that disputes arising under the franchise agreement are to be mediated prior to suit, but significant related agreements (perhaps with overlapping or different parties) do not, or if one agreement requires arbitration and the others do not, then a franchisor may be forced to resolve simultaneous disputes of the two (or more) agreements using different methods and, perhaps, in different locations. This could result in additional expense or, worst case, inability to effectively resolve the entire dispute in a timely manner.

IV. UFOC IMPLICATIONS

A. Which "Other Contracts" Have to be Included as UFOC Exhibits?

Item 22 of the UFOC Guidelines sets the standard for contracts that must be included as exhibits. Item 22 states: "Attach a copy of all agreements proposed for use or in use in this state regarding the offering of a franchise, including, the franchise agreement, leases, options and purchase agreements" (emphasis added). Thus, the test for inclusion in Item 22 is whether the agreement is one "regarding the offering of a franchise." The phrase is not self-explanatory. The Item 22 instructions elaborate on the basic requirement, but not much. Instruction i states: "Copies of agreements attached to the offering circular under Item 22 are part of the offering circular. Each offering circular delivered to a prospective franchisee must include copies of all agreements to be offered." Instruction ii adds only: "The franchisor may cross reference Item 10 for financing agreements." In Item 10 itself, Instruction x directs the franchisor to "include specimen copies of the financing documents as an exhibit to Item 22."

Other sections of the UFOC Guidelines impose numerous requirements for disclosure of information about "other contracts" but do not specifically require any contracts to be included as exhibits to the UFOC. Some (not exhaustive) examples:

- Item 8 would require information about supply contracts with the franchisor, its affiliates, or designated outside vendors (Sections II.A.2.g and II.B.3 above).

- Item 11.A calls for a listing of the franchisor's pre-opening obligations, with citations to the applicable provisions of "the agreement requiring performance." This disclosure obligation clearly is not limited to the franchise agreement itself. Indeed, the instructions to Item 11.A refer to activities that, as discussed in this paper, are often set out in agreements separate from the franchise agreement (*e.g.*, site selection, construction, training, equipment leasing, and obtaining supplies). Similarly, if the franchisor uses a marketing co-op agreement (Section II.A.3.a above), Instruction ii to Item 11.B would require extensive information about the terms of the agreement. Instruction iii to Item 11.B has the same effect with respect to any computer system agreements (Section II.A.2.d). Item 11.C would require description of a site selection addendum (Section II.A.2.b) if not already covered in Item 11.A, and Item 11.E would require description of any training agreement (Section II.A.1.c).

- Item 13.C requires disclosure of agreements which significantly limit the rights of the franchisor to use or sublicense the trademarks associated with the franchise concept. An inter-affiliate IP license between the franchisor and its affiliate (Section II.C.1) falls squarely within this category. (Item 14 contains a parallel requirement for agreements affecting patents and copyrights.)

- Item 15 requires the franchisor to "disclose the franchisee's obligation to participate personally in the direct operation of the business." Instruction i directs the franchisor to include obligations arising from, for example, a personal guaranty (discussed in Section II.A.2.a). Instruction iii adds a requirement to disclose "restrictions which the franchisee must place on its manager (for example, maintain trade secrets, non-competition)," which would capture the agreements discussed in Section II.B.1.

We will address Items 9 and 17 in the next section.

As noted above, the standard set forth in Item 22 – "agreements . . . regarding the offering of a franchise" – does not by itself clearly answer which contracts must be exhibits to the UFOC. The official Commentary to the UFOC Guidelines dated April 18, 1999 provides no guidance on this point. Considering the examples given in Item 22, however ("leases, options and purchase agreements"), the authors believe it is reasonable to interpret the requirement as applying only to agreements that the prospective franchisee would be required to sign, would have the option to sign, or would commit to sign at or before the time of becoming a franchisee.

B. Which Ones Need a Chart in Item 9 and/or Item 17?

Item 9 of the UFOC requires the franchisor to "Disclose the principal obligations of the franchisee under the franchise and other agreements after the signing of these agreements" (emphasis added). Similarly, Instruction iii to Item 9 mandates inclusion of the following statement: "This table lists your principal obligations under the franchise and other agreements. It will help you find more detailed information about your obligations in these agreements and in other Items of this offering circular." Thus, at first blush Item 9 seems broader than Item 22, which has the "regarding the offering of a franchise" qualifier.

Item 17 sets what appears to be a different standard from both Item 9 and Item 22. Item 17 states: "Summarize the provisions of the franchise and other agreements dealing with termination, renewal, transfer, dispute resolution and other important aspects of the franchise relationship" (emphasis added).

Conceivably, because of the different wording, a contract might be within Item 9 or 17, but not within Item 22, or vice versa. However, Instruction i of Item 17 sets out a mandatory statement for the beginning of Item 17, which reads: "This table lists certain important provisions of the franchise and related agreements. You should read these provisions in the agreements attached to this offering circular" (emphasis added). Thus, Item 17 seems to assume that every contract covered in Item 17 will be an exhibit in Item 22. On the other hand, Instruction i potentially changes the standard again by introducing the term "related" agreements.

Instruction iii of Item 17 confuses the issue a bit more: "Use a separate table for any other significant franchise-related agreements. If a provision in any other agreement affects the provisions of the franchise or franchise-related agreements disclosed in this Item (for example, the term of the franchise will be equal to the term of the lease), disclose that provision in the applicable category of the table" (emphasis added).

Once again, the official Commentary provides no help in reconciling these UFOC provisions. So what to make of all this?

We believe that the scope of contracts within Item 17 is somewhat narrower than that of both Items 9 and 22. Item 17 contains the clearest limitation, namely, that disclosure is necessary for "agreements dealing with termination, renewal, transfer, dispute resolution and other important aspects of the franchise relationship." We think the later use in Item 17 of the terms "related agreements" and "franchise-related agreements" are essentially shorthand for the longer "dealing with" standard.

Thus, if an "other contract" affects one or more of these aspects of the franchise agreement (*e.g.*, though a cross-default provision), the other contract must be included in the Item 17 table. Moreover, if the other contract is "significant," Item 17 requires a separate table for the other contract rather than a summary of provisions within the franchise agreement table (although the Commentary permits use of a separate column within the same table if it can be done clearly). If the "other contract" is not "franchise-related," it may nevertheless still be an "other agreement" as used in Instruction iii of Item 17, in which case disclosure is still needed to the extent that the other contract affects disclosures about other agreements in the table.

As for Item 9, "other contracts" should be included in the table to the extent that they contain provisions responsive to the disclosure categories in the Instructions to Item 9. As a practical matter, we think this obligation reaches only to contracts that are required exhibits under Item 22, but as noted above there is an argument that Item 9 is even broader.

V. THE LITIGATION RECORD

Most of the reported case law involving multi-contract franchise relationships focuses on the relationship among the contracts themselves. Frequently, the question boils down to whether the separate agreements will be enforced independently of each other, or whether they will instead be construed as parts of a single contractual unit. As a general rule, two or more agreements that are executed by the same parties at or about the same time and concern the same transaction or subject matter are construed together as a single contract.

Also relevant to the determination, of course, are provisions in the contracts themselves which purport to dictate the effect that one will have on the other. At one end of the spectrum, merger and integration clauses seek to obliterate all extraneous agreements. At the other end, cross-default provisions effectively incorporate the provisions of parallel agreements.

The question of single versus separate agreements has arisen in a variety of litigation contexts. The answer to the question has often had a significant, and sometimes surprising, impact on the resolution of the underlying dispute. Examples are discussed below.

A. ***Brennan* and *Clayton*: A Failed Integration, and a Justification For Unpaid Royalties**

The potential implications of having more than one contract in a franchise relationship which has turned sour are perhaps most compellingly illustrated by the contrasting results reached in a pair of federal appellate court cases decided within a year of each other in the early 1990s.

In *Brennan v. Carvel Corp.*,[5] the franchisees, before entering into the franchise agreement itself and in connection with the payment of a $1,000 deposit on the prospective franchise, entered into an "Application and Deposit Agreement" which recited that the franchisor would exert "a substantial amount of time and effort . . . in seeking, surveying and showing locations suitable for a Carvel store," and also made reference to "the services to be rendered to the Applicant hereunder." The franchise agreement which the parties subsequently executed contained a standard merger clause, providing that "any rights which the respective parties hereto may have had under any other previous contracts are hereby cancelled and terminated." In connection with entering into the franchise agreement, the franchisees also signed several "sales contracts," one of which assessed a $2,500 "real estate services fee" against them for unspecified real estate services.[6]

The franchised store ultimately failed, and the franchisees sued Carvel in federal district court, obtaining judgment and nearly $800,000 in damages on their claim that Carvel breached its obligation under the Deposit Agreement to evaluate and approve a suitable location for the store. On appeal, the First Circuit upheld the judgment, rejecting Carvel's argument that the claim was barred by the merger clause in the franchise agreement. Under the applicable law, a contract found to be separate and collateral to the main agreement, and not inconsistent with its terms, was enforceable notwithstanding the integration of the main agreement. The court found that the Deposit Agreement was enforceable as such a separate and collateral contract, relying, *inter alia*, on the terms of the agreement and the facts that (1) the franchise agreement contained no reference to site selection; (2) the Deposit Agreement was supported by independent consideration; and (3) the franchisees were charged $2,500 for "real estate services."[7]

[5] 929 F.2d 801 (1st Cir. 1991).

[6] *Id.* at 804-05.

[7] *Id.* at 807-08.

In *Clayton v. Howard Johnson Franchise Systems, Inc.*,[8] the existence of two distinct contracts and the application of other rules of contract construction brought about a result equally detrimental to the franchisor. The contracts at issue were a Motel License and a Restaurant Lease. Under the former, the franchisees operated a Howard Johnson's motel on land which they owned; under the latter, the franchisees leased to Howard Johnson's, and Howard Johnson's operated, a restaurant next to the motel on the same land. In the litigation, the franchisees claimed that Howard Johnson's failed to provide food services to the motel, and Howard Johnson's claimed that the franchisees failed to pay royalties.

The Eleventh Circuit, reversing the district court, held that the Motel License and the Restaurant Lease were required to be construed together as a single franchise agreement. The court based this conclusion on the fact that the two documents were executed on the same date; dealt with the operation of related businesses situated contiguously on the same land; contained numerous cross references to each other; and contemplated that they would have coextensive terms.[9] The court further found that the two documents, construed together, were ambiguous on the question of whether Howard Johnson's was obligated to provide food services to the motel, and remanded the case for a finding on that issue.[10] Finally, the court reversed the lower court's judgment against the franchisees on Howard Johnson's claim for nonpayment of royalties, holding that, if the franchisees proved on remand their claim that Howard Johnson's breached a duty to provide food services, that breach – because the two contracts were to be construed as one – would constitute a justification for the franchisees' refusal to perform their obligation to pay royalties.[11]

Results similar to that in *Clayton* are not uncommon in cases involving multi-contract business relationships. Other courts have held that contemporaneously executed promissory notes would be treated as a single contract with a distributorship agreement where the notes financed the distributorship fee;[12] that a gasoline company's breach of its repair obligation under its agreement with a gas station operator justified the operator's termination of both that agreement and the lease for the station premises;[13] and that a franchisor's fraudulent inducement in connection with a franchise agreement barred it from suing on a promissory note executed by the franchisee in

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[8] 954 F.2d 645 (11th Cir. 1992).

[9] *Id.*at 649.

[10] *Id.*at 650.

[11] *Id.*at 651.

[12] *Carvel Corp. v. Diversified Management Group, inc.*, 930 F.2d 228 (2d Cir. 1991).

[13] *Amoco Oil Co. v. Gomez*, 125 F. Supp.2d 492 (S.D. Fla. 2000).

connection with his purchase of the franchise.[14] By contrast, few courts have followed the lead of *Brennan* in relieving a franchisee of the effect of a valid merger clause.[15]

A *Clayton* style of result is less likely to be reached in a case where separate agreements govern separate franchised businesses, even if they are between the same parties. A recent example is *Manpower, Inc. v. Mason*, [16] which involved a staffing service franchisee that operated businesses in three cities under three identical agreements, and breached its obligations only with respect to one. The court in *Mason* rejected the franchisor's attempt to rescind the two compliant franchises together with the derelict one. The court stated that, "[u]nder traditional contract law principles, in the absence of evidence of the parties' intention to treat separate agreements as a single indivisible contract, separate contracts are treated separately. Thus, the fact that a franchisee operating a number of franchises breached one agreement does not mean that it breached another."[17] Interestingly, the court proceeded to note a commentator's recommendation that franchisors include cross-default provisions in their agreements "to retain maximum flexibility in dealing with franchisees."[18]

Although the result in *Mason* may appear to present a departure from the rationale of cases like *Clayton*, the two are readily reconcilable on a more fundamental level. Where separate contracts are used to build a single business operation – as was the situation in *Clayton* and the other cases cited above – it makes sense to construe them together as parts of an integrated unit. That was not the situation in *Mason*, where three distinct businesses operated separately, albeit under common ownership. In such a case, as the court properly concluded, there is no basis on which to infer an intent to create a single integrated contract. Such intent, if it exists, must be clearly expressed.

B. Single or Separate Contracts – Other Implications

The determination of whether to construe multiple contracts as independent or as a single unit has had relevance to issues beyond the basic one of breach – in some cases, with equally dispositive results.

1. Coverage Under Statutes

As is well known, litigation involving statutory protections of franchisees or dealers often focuses, in the first instance, on whether the business relationship at issue

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[14] *Westbury Small Business Corp. v. Ballarine*, 489 N.Y.S.2d 815 (N.Y. Sup. 1985), *aff'd*, 509 N.Y.S.2d 569 (2d Dep't 1986).

[15] Where a similar result was reached, it was predicated on the fact that the prior agreement was signed by an individual and the main agreement by a corporation which he formed. The court held that, "as a matter of law, the letter agreement and the distribution agreement cannot merge because the two agreements are between different parties." *Fish v. Tandy Corp.*, 948 S.W.2d 886, 899 (Tex. App. 1997).

[16] 405 F. Supp. 2d 959 (E.D. Wis. 2005).

[17] *Id* at 975.

[18] *Id.*, citing 1 W. Michael Garner, Franchise & Distribution Law & Practice § 3.3. (2005).

qualifies as a "franchise" or "dealership" under the definition set forth in the statute. Where putative franchise or dealer relationships have involved more than one contract, issues of coverage under the applicable definition have arisen from at least two different perspectives.

The first is the "creeping franchise" situation – where none of the contracts individually satisfies all the requisite elements of the statutory definition, but each satisfies some, thereby raising the question of whether the contracts may be combined to form a single franchise or dealer relationship that is entitled to protection under the statute. A case arising under the Automobile Dealer's Day In Court Act recently answered that question in the affirmative.[19] Similarly, the Petroleum Marketing Practices Act has been held to require that a gas station lease and retail dealer contract "must be construed together as one contract – the franchise agreement."[20]

A contrasting situation was presented in another recent case,[21] in which the parties to a dealer agreement, which presumably (though the issue was not reached) would have qualified as a "dealership" under the applicable statutory definition, subsequently entered into a separate agreement providing different terms with respect to sales to one particular customer (*i.e.*, sales on a commission rather than resale basis). The manufacturer later terminated that "sales agreement," leaving the dealer agreement intact. The Seventh Circuit rejected the dealer's argument that the termination violated the Wisconsin Fair Dealership Law, upholding the district court's determination that, based on the undisputed facts in the record, "the parties entered into two distinct agreements as a matter of law[.][22] In reaching that conclusion, the court was clearly impressed by the fact that the two agreements provided entirely distinct arrangements for the sale of the manufacturer's product, finding that that fact "belied" the dealer's contention "that the sales agreement was merely a modification of the earlier dealer agreement."[23]

2. <u>Arbitration of Disputes</u>

The arbitrability of a dispute that arises under an agreement that does not itself contain an arbitration clause, but is related to an agreement that does, is a question that generates a significant amount of litigation. Some courts articulate a general rule that arbitration of a "collateral" dispute arising out of a separate contract cannot be compelled on the basis of an arbitration clause in the main agreement.[24] As a practical matter, however, the resolution of the issue generally turns on the breadth of the arbitration clause. An agreement to arbitrate "any and all disputes" between the parties, or all

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[19] *Arciniaga v. General Motors Corp.*, 418 F. Supp. 2d 374 (S.D.N.Y. 2005).

[20] *Prestin v. Mobil Oil Corp.*, 741 F.2d 268, 272 (9th Cir. 1984).

[21] *Eisencorp, Inc. v. Rocky Mountain Radar, Inc.*, 398 F.3d 962 (7th Cir. 2005).

[22] *Id.* at 966.

[23] *Id.*

[24] *Wilson v. Subway Sandwich Shops, Inc.*, 823 F. Supp. 194 (S.D.N.Y. 1993). *See also Industrial Electronics Corp. of Wisconsin v. iPower Distribution Group, Inc.,* 215 F.3d 677 (7th Cir. 2000).

disputes "arising out of or related" to the contract in which the clause appears, will usually be held to encompass disputes arising out of related, albeit separate or "collateral," agreements.

The leading case on this point in the franchise context is *Neal v. Hardee's Food Systems, Inc.*[25] In *Neal*, the franchisee entered into a Purchase Agreement by which he acquired from the franchisor the real and personal property comprising the restaurants that were the subject of six individual license agreements contemporaneously entered. The license agreements all contained broad arbitration clauses applicable to "any and all disputes" between the parties. The relationship subsequently deteriorated and the franchisee filed suit, asserting that his claims could be litigated because they arose not under the license agreements, but under the Purchase Agreement, which did not contain an arbitration clause. The Fifth Circuit disagreed. Reciting the general principle that "separate agreements executed contemporaneously by the same parties, for the same purposes, and as part of the same transaction, are to be construed together," the court found that the Purchase Agreement and license agreements were "integral and interrelated parts of the one deal."[26] The arbitration clause in the license agreements was "intended to reach all aspects of the parties' relationship."[27]

Numerous courts have compelled arbitration of "collateral" disputes on the basis of rationales similar to that articulated in *Neal*.[28] Where a contrary result has been reached, it has generally involved an arbitration clause narrower in scope – i.e., one limited to disputes "arising out of this agreement."[29]

3. <u>Bankruptcy</u>

When a franchisee files for bankruptcy, the franchise agreement becomes part of the estate, subject to assumption or rejection by the trustee or debtor-in-possession, unless it has been effectively terminated by the franchisor pre-petition. This general rule may be subject to a unique twist in the context of multi-contract franchise relationships – depending, once again, on whether the separate contracts are deemed to form part of a single, "indivisible" unit.

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[25] 918 F.2d 34 (5th Cir. 1990).

[26] *Id.* at 37.

[27] *Id*. at 38.

[28] *See, e.g., Ferrari North America, Inc. v. Ogner Motor Cars, Inc.,* 2003 WL 102839 (S.D.N.Y. 2003); *Cash America Int'l, Inc. v. Exchange Services, Inc*., 83 S.W.3d 183 (Tex. App. 2002); *Cash Converters USA, Inc. v. Burns*, 1999 WL 98345 (N.D. Ill. 1999); *Jab Industries, Inc. v. Silex S.p.A.,* 601 F. Supp. 971 (S.D.N.Y. 1985); *Precision Husky Corp. v. Mountain Equipment*, 2004 WL 2699920 (Wash. App. 2004).

[29] *In re Sino Swearingen Aircraft Corp.,* 2004 WL 1193960 (Tex. App. 2004). *But see Industrial Electronics Corp., supra* (declining to compel arbitration, even though clause at issue applied to "related" disputes).

In *In re Karfakis,*[30] the debtors were both the franchisees under a franchise agreement and the lessees under a lease for the franchised store premises held by an affiliate of the franchisor. The debtor-franchisees sought to sell their business as part of their plan of reorganization. In a motion for relief from the automatic stay, however, the franchisor maintained that the franchise agreement and lease had been terminated prior to the bankruptcy filing, leaving the debtors with no assets to sell. The debtors countered that neither contract had been effectively terminated pre-petition – and, alternatively, that the franchise agreement and lease constituted "one indivisible agreement," so that, if *either one* had not been effectively terminated, "the entire agreement remains extant, and the Debtors' interest therein forms property of the Bankruptcy Estate."[31]

The court found the debtors to be correct as a matter of both bankruptcy and contract law. It found, based on the evidence before it, "that the Franchise Agreement and the Lease are inextricably interwoven and for all practical purposes comprise a single contractual relationship. Aside from being coterminous and containing cross-default provisions, it is readily apparent that one agreement is of no utility without the other. The Franchise Agreement permits the Debtor to operate a specific Franchise Store at a specific location which is simultaneously leased to the Debtor/Franchisee by a [franchisor] affiliate as Lessor. . . . The court is persuaded by these facts that the parties intended the two separate contracts . . . to constitute a single, contractual agreement."[32] The court then found, based on the evidence before it, that while the franchise agreement had been effectively terminated pre-petition, the lease, under the applicable state law, had not, thereby leaving "that component of the relationship extant on a post-petition basis." The court concluded that "partial termination of an integral two-part agreement on a pre-petition basis is ineffective to render the entire agreement terminated on a pre-petition basis, and that the . . . Franchise/Lease Agreement as a whole has, therefore, survived post-petition."[33]

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In sum, the lesson to be drawn from the litigation record is both intuitive and practical. Separate contracts which combine to produce the component elements of a single franchised business are likely to be treated as a single contract – whereas separate contracts which create distinct business relationships are likely to be treated individually, even where the same parties are involved. More fundamentally, the lesson is a familiar one – *i.e.*, that careful drafting is a worthwhile investment. Comprehensive planning for the interplay of "other contracts" is not always possible, because sometimes they arise in response to unforeseen events. Nevertheless, parties have the opportunity to make their intentions clear if they will simply be mindful of the issue in the drafting process. If they do not seize this opportunity, the parties will be at the mercy of legal precedents and presumptions rather than business considerations.

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[30] 162 B.R. 719 (Bankr. E.D. Pa. 1993).

[31] *Id.* at 725.

[32] *Id.*

[33] *Id.* at 727.

V. CONCLUSION

The franchise relationship is a complex commercial arrangement, involving a myriad of duties and responsibilities, with the potential for substantial benefit and serious pitfalls. Creating a smoothly operating franchise system is, to a great extent, a product of thoughtful, well-structured contract development and drafting. Blind adoption of forms and failure to think through, and adequately address, the complexity of the relationship may limit the success of a franchise system, and thus the success of both the franchisor and franchisee. Sufficient attention not only to the franchise agreement, but to the "other contracts" in the franchise relationship, will help ensure a positive experience for both the franchisor and the franchisee, from the start of the relationship through its end.