

LIFOCUS – LAW

Franchises and the Law

A focus that calls on many areas of legal expertise

By **KRISTEN D'ANDREA**

Many small business owners are lured by the instant recognition that comes with the purchase of an already-established franchise. However, the fact that a franchise is well-known does not guarantee its success.

The fundamental concept of a franchise is a business that enables its owners to buy a brand and hit the ground running, ideally earning revenue from day one, according to Leonard Bellavia, a senior partner at Bellavia, Blatt, Andron & Crossett of Mineola and Hauppauge.

“But, it can be a perilous path,” he said. “Sometimes it sounds too good to be true.”

Before entering into a franchise agreement, franchisees – those who purchase a trademarked product or service either directly from a manufacturer or business owner, or indirectly from a fellow franchisee – should recognize the franchise relationship will be both long-term and highly capital-intensive, according to Bellavia, whose firm spends 90 percent of its time focused on franchise law.

While people tend to associate franchises with fast-food chains, the industries in which franchises extend are widespread, including daycare centers,



LEONARD BELLAVIA: Franchisors often complain franchises are underperforming, while franchisees say it's not their fault.

Photo by Bob Gigliane

printing facilities, employment service agencies, medical facilities, yogurt shops, car and boat dealerships and taxi cab services, to name a few.

“There’s a lot of opportunity out there,” Bellavia said. “Due diligence is the key term.”

Finding a lawyer who specializes in franchise law can be the first step toward ensuring a successful franchise relationship.

East Meadow-based attorney Harold Kestenbaum represents the interests of franchisors. He stresses the importance for clients to seek the counsel of attorneys who have expertise in this area of the law.

“Lawyers who do a little bit [of franchise work] shouldn’t do any of it,” he said. “If you don’t do this for a living, you’re not a franchise lawyer and you shouldn’t hold yourself out to be.”

Kestenbaum, who represents franchisors all over the country and authored the book “So You Want to Franchise Your Business,” said he acts as a general contractor, often bringing in specialists to deal with certain disciplines of the law, such as trademark law, which is “the cornerstone of every franchise.”

In addition to knowledge of trademark law, franchise agreements often call upon many other disciplines, such as real estate, contract and construction law. There can be potential human resources issues involved in setting up a business; negotiation of the franchise fee; possible environmental concerns, depending on the nature of the business; and issues related to leasing the property, construction, municipal zoning and variances, Bellavia said. In addition, franchisors have many of their own concerns, such as compliance, contract and franchisee issues.

Still, the initial phase, during which franchisees and franchisors agree to a franchise disclosure document, is when due diligence is most important. Baldwin-based franchise attorney Chandra Ortiz said she advises clients to research the background of the principals involved in the franchise.

“Check out the faces behind the name,” she said, noting the principals could have lawsuits against them or have had other businesses that didn’t fare well.

If the franchisor has already developed a location, franchisees should run municipal searches to make sure permits are valid for that location.

“The goal is not to have any dramas as you develop your business,” she said.

If franchisees are buying an existing location from an existing franchisee, doing research to determine exactly which assets are being purchased is critical, Ortiz said.

“You want to make sure you find out who has the interest,” she said. “Did they pledge the franchise as collateral for a loan? You want to make sure there are no liens on the equipment you are purchasing.” Generally, she advises clients to buy the assets of an establishment, rather than the entire business.

“You don’t want to buy their problems,” Ortiz said.

Once the franchise disclosure document has been reviewed by an attorney and agreed upon, other issues may arise requiring the assistance of legal counsel.

Although franchisees are entrepreneurs, the franchisors are still their boss, Ortiz said.

“In addition to laws governing this area, many franchisors have policies that [franchisees] must be familiar with” to understand how they will affect future plans, she said. These policies can range from who can own the franchise business to whether or not it can be passed along to heirs.

Still, Kestenbaum said, successful relationships are viewed as partnerships and collaborations, rather than employer and employee affiliations, he said.

“If somebody puts up \$300,000 or \$400,000, they don’t want to be treated like an employee,” he said. “Good franchisors are successful because franchisees are successful.”

Bellavia said he often handles cases involving disgruntled franchise owners who say they are being oppressed and not receiving proper allocation of their product. Franchisors may have their own struggles, which can trickle down to franchisees. However, inadequate supply can lead to financial drain, Bellavia said.

“The last thing [a franchisee] wants to do is engage in litigation with a franchisor, although it’s necessary some-

times to show the franchisor you will take them to task,” he said. Nine times out of 10, issues can be resolved with a less confrontational approach. However, there are times when it pays to take an aggressive position with franchisors, Bellavia said.

On the other hand, clients frequently come to Kestenbaum complaining that their franchisees are not performing or paying their royalties – a percentage of the weekly or monthly gross income that goes back to the franchisor. Kestenbaum recommends franchisors remain heavily involved in their franchisees’ business, which may mean conducting weekly conference calls or visits.

“If someone starts missing royalties, you have to immediately pick up the phone to find out what’s going on,” he said, adding, “communication is key in franchising.”

The most common tug of war in a franchise relationship involves franchisors complaining about franchisees underperforming; in turn, franchisees claim it’s not their fault, according to Bellavia. Franchisors may recommend a struggling franchisee sell the business rather than risk being terminated. Otherwise, a disagreement surrounding termination could lead to costly litigation, Kestenbaum said.

While the franchise agreement offers certain rights to the franchisor, fights often ensue over whether the franchisee breached the contract or did the best it could. Generally the franchisor will buy the franchisee out or let the franchisee sell the business.

“The biggest mistake a franchisee can make is to walk away without recouping their investment,” Bellavia said.

Bellavia is currently involved in a \$50 million lawsuit against an Amityville-based auto company trying to purchase all of the Jaguar Land Rover dealerships on Long Island. He’s also been involved in recent disputes with flower stores and ice-cream shops.

“The issues are the same, whether [the franchise] is selling a \$100,000 item or a \$12 bouquet of flowers,” he said. “They’re transferrable legal concepts.”