An Entrepreneurs Guide to Purchasing a BUSINESS or FRANCHISE

CHARLES N. INTERNICOLA is a leading business and franchise attorney with a legal practice dedicated to protecting the interests of individuals (including first time business purchasers) and non-public corporations in local, regional and national transactions. Mr. Internicola’s franchise practice is national in scope and involves the representation of franchisees (considering the purchase of a franchise) and franchisors (establishing a franchise system) throughout the United States. For more information about Mr. Internicola and the services offered by his law firm, visit www.BusinessandFranchiseLaw.com or call 800-976-4904.

SOME OF THE IMPORTANT INFORMATION INCLUDED IN THIS BOOK

• The 5 myths that must be ignored when purchasing a business;
• Special factors and information unique and important to “franchisees”;
• How to identify and evaluate the “assets” of a business;
• “Due diligence” and the critical factors for evaluating a business;
• Important factors for evaluating a lease; and
• How to protect yourself after the business closing.

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Business and Franchise Lawyer
An Entrepreneurs Guide to Purchasing a BUSINESS or FRANCHISE

A Practical No Nonsense Guide to Educate, Inform and Empower Business Purchasers and Prospective Franchisees
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Is this book for you?

Yes, if you are considering the purchase of a business or franchise.

The process that you are considering or about to embark on—the process of buying a business or franchise—will have long-standing implications for your financial and personal well-being for many years to come. During this process it will be critical for you to “thoroughly assess the proposed transaction”, “ask the right questions”, conduct the “necessary due diligence” and make informed decisions about your legal rights and obligations. So, before making this “entrepreneurial leap” take the necessary time, now, to equip yourself with the information, tools and resources to properly approach the business decisions that remain ahead.

Who wrote this book?

I am a business and franchise lawyer. I represent entrepreneurs, entrepreneurs that include individuals purchasing a business or franchise for the first time and experienced hard working business owners of established and successful corporations. I have and continue to represent individuals, like you, who are considering the purchase of a business or franchise.
Why did I write this book and what should you expect from it?

I wrote this book to level the playing field for the business and franchise “purchaser”. When purchasing a business or franchise (either for the first time or the fifth time) there is a lot at stake with a small margin for error and a short time period to get everything right. In too many business transactions, business and franchise purchasers—entrepreneurs in their own right—are presented with insufficient information and resources to “timely” and “properly” assess the business transaction.

The goal of this book is to expose you—the prospective business or franchise purchaser—to critical information and issues that you must be aware of prior to signing any agreement or paying any contract deposit or franchise fee. Equipped with the information contained in this book, it is my goal that you will be empowered to better question, guide, assess and participate in your purchase transaction.

What is the difference between a business and a franchise?

Actually, there is no difference, only a distinction: a franchise is a “type” of business or business model. In this book I make a distinction between these two terms to more precisely address the legal and business issues that you may encounter in your proposed business transaction. When I refer to a “business” I am referring to a non-franchised independently established business. When I refer to a “franchise” I am referring to a business that is part of a national or regional franchise system that is or will be owned and operated by you, as a franchisee, pursuant to the terms of a franchise agreement.
The types of business transactions that we will discuss and address in this book, include:

- The purchase of an “existing” (non-franchised) business;
- The purchase of an “existing” franchised business; and
- The establishment of a “new” franchised business.

Many of the issues discussed in this book will be applicable to each of the foregoing transactions—whether or not the business is also a franchise. However, when dealing with the purchase of a franchise you will encounter additional legal issues and factors that will require identification and evaluation. We will discuss these additional “franchise factors” in this book.

A quick note about corporate entities, the seller and the purchaser.

As you are probably aware, the majority of businesses, including the one that you may be purchasing, are owned by legal entities such as a corporation or limited liability company and not the “individual” operator of the business. As such, typically, the “business seller” will be a “legal entity” that is owned and controlled by the individual operator of the business.

When discussing transactions involving the resale of an existing business, throughout this book, I make the assumption that the “business seller” is a corporate entity that owns the assets of the business that you may be purchasing. So, when I refer to the “seller”, it is the corporate entity that I am referring to.
When I refer to the “purchaser”, I am referring to you—the potential purchaser of a business. In doing so, I make the assumption that, initially, you will be involved in the “purchase transaction” in your individual capacity and that as the transaction progresses—after you have identified the business that you are interested in, completed your due diligence and have elected to proceed with the business transaction (all factors discussed in this book)—you will be establishing a corporate entity to serve as the ultimate purchaser. The type and nature of the corporate entity that you will ultimately establish and utilize will be based on legal and accounting factors that you must discuss with your business attorney and accountant.

This book should not and cannot be relied upon as legal advice.

This book is not intended to contain legal advice and should not be relied upon as legal advice. This book is not intended to replace the advice of an attorney that you should retain for your business transaction and cannot serve as a replacement for the individual and transaction specific advice and counseling that you will require from an experienced business and franchise attorney. You must verify the accuracy and applicability of the information contained in this book with your licensed attorney and should not rely upon same. This book does not offer legal advice—only important information—and does not serve to create an attorney-client relationship with either my law firm or myself. Please note that I can only consider establishing an attorney-client relationship after reviewing your potential legal matter and establishing a written agreement as to the scope of my legal services.
Before we get into the detail of purchasing a business or franchise, please know that the following “myths” are wrong and must be ignored:

Myth No. 1: If gross sales are substantial, the business must be profitable.

Why this myth is absolutely wrong:

When evaluating a business, “profits” and “cash flows” are critical factors that must be assessed. Always distinguish “cash flows” from “gross revenue” and recognize that business records and information that substantiate only “gross sales” will be insufficient for completing your due diligence investigation. Although a business may be generating, “substantial revenues”, it is nevertheless possible that expenses (for items such as rent, supplies, royalties, etc…) are equally substantial and that the business is not profitable. As a business owner, when faced with paying your bills and supporting your family, you will be judging and evaluating your business not based on “gross sales” but rather “cash flow” and “profits”. That is, the suc-
cess or failure of the business will be judged by the money that you take home to your family.

The distinction between profits and gross revenue is especially important when evaluating the purchase of a franchise. When buying a franchise you must recognize that although your franchised business may generate higher revenues (compared to a local non-franchised competitor) you will, most likely, incur higher operating expenses and fees, such as, royalties, advertising funds and the costs associated with the purchase of proprietary products.

**Myth No. 2:** Since the business involves significant “cash sales” i can only rely on the seller’s revenue representations.

**Why this myth is absolutely wrong:**

First, a good business person should recognize the importance of accurately reporting his or her income. When purchasing a business you cannot simply rely on the statements and information provided to you by the seller. If the seller claims that his or her financial statements “under-report” sales then you must proceed with caution and, at a minimum, speak to your business attorney about structuring a “due diligence” contingency into the purchase agreement. If structured properly, the “due diligence contingency” will provide you with access to the business and enable you to independently evaluate the day-to-day operations and financial performance of the business.

If the business is an existing franchise your “due diligence” efforts may be assisted by detailed royalty reports and other electronic
records that franchisees are typically required to retain and electronically transmit to the franchisor. The royalty reports should give you solid information about the businesses sales. However, since royalties are typically based on “gross sales” the royalty reports will not assist you in evaluating the cost structure or profitability of the business. However, the information contained in the royalty report may provide a good starting point.

**Myth No. 3: The purchase agreement is a standard “legal document” that will not require my input.**

**Why this myth is absolutely wrong:**

When purchasing a business or franchise your “purchase agreement” will represent a critical “life-line” that you will rely upon to ensure that the business you are buying—or the franchise that you are investing in—matches your expectations. Every business is unique with different tangible and intangible assets. As such, your purchase agreement (or franchise agreement) must reflect the unique nature of the business assets that you will be acquiring. To do this, you must actively consult with your business attorney and discuss the legal protections and provisions to be implemented into your purchase agreement. Some of the many critical factors that should be evaluated and discussed with your business attorney include:

- Protection of customer contracts;
- Protection of customer lists and information;
- Continued employment of key employees and managers;
- Supply agreements with specialized vendors;
• Regulatory compliance of specialized equipment;
• Environmental condition of the leased premises;
• The necessity of implementing a “due diligence contingency”;
• The necessity of implementing a “lease agreement contingency”;
• Site selection addendum for the location of a new franchise;
• Limitations on your “personal” liability in the lease; and
• Limitations on your “personal” liability in the franchise agreement.

There are many other factors and the best way to identify and address these “contract issues” is to engage in an active discussion with your business attorney before you sign any agreements. Start off with discussing what you expect from the business and the assets that make the particular business or franchise valuable.

Myth No. 4: Since the business is established, reserve capital is unnecessary.

Why this myth is absolutely wrong:

Possessing sufficient funds and resources to satisfy the purchase price or franchise fee is only the first step. You must allocate and possess sufficient additional capital (cash, line of credit, etc…) to serve as a reserve to allow for the transition of the business and
account for a slow period of sales. Reserve capital is also important when the business is required to carry and maintain inventory. Always find out if inventory is included in the purchase price and, if not, recognize that you will need additional capital to either purchase the seller’s inventory or buy your own. Set a budget and anticipate establishing a reserve of at least three months. Consider your personal living expenses when setting this reserve.

If the business is a franchise, the franchisor’s “Franchise Disclosure Document”—FDD—should include the franchisors estimates of your anticipated start-up expenses. These estimates should be included in “Item 7” of the FDD titled “Your Estimated Initial Investment”. Carefully review the estimates contained in Item 7 and verify the information contained in Item 7 with existing franchisees and your accountant. Included in the franchisor’s Item 7 disclosure should be an estimate for additional funds and reserve capital. Always consider maintaining more “reserve capital” than even recommended by the franchisor.

**Myth No. 5: My franchise agreement is not negotiable—so I might as well just sign it.**

**Why this myth is absolutely wrong:**

In certain “franchise sales settings” franchisees are sometimes led to believe that modifications cannot be legally made to their franchise agreement. That is, to induce a franchisee to sign the franchise agreement—without the benefit of any negotiations or an in depth review by a franchise attorney—some prospective franchisees are led to believe that the franchise agreement is a “standard
agreement” (signed by everyone) and that, legally, the franchisor is not permitted to make any changes. The implication by the franchisor’s sales agent being “you might as well just sign the agreement and not waste time or money since we can’t change the franchise agreement even if we wanted to”. Sadly, this misstatement may lead to a false sense of security for prospective franchisees. To be clear:

- Franchise agreements are negotiable;
- It is not illegal for a franchisor to modify its franchise agreement;
- It is extremely common for franchisees to negotiate certain aspects of the franchise agreement; and
- Even if the franchisor were unwilling to negotiate the terms of the franchise agreement, it is nevertheless critical that you understand the legal obligations that you will be undertaking and obligating yourself to in the franchise agreement.

Keep in mind that the extent to which a franchisor may be willing to negotiate the terms of its franchise agreement will vary depending on the negotiating power of the parties and the negotiation strategy that you adopt. Sometimes, minor changes will make a substantive impact on your long-term rights and obligations as a franchisee. Franchise agreements are serious legal documents—treat them as such.
Franchise Factors: A General Overview of Franchise Transactions

Note to reader:

The primary purpose of this chapter is to address and make you aware of the unique factors associated with franchise transactions. If you are not considering the purchase of a franchise then you could skip to the next chapter. However, even if you are not purchasing a franchise, the information contained in this chapter will, nevertheless, add a useful perspective to your overall understanding of business transactions and critical factors that you should be aware of when buying a business.

As discussed in the introduction, in this book, a distinction is made between business transactions involving:

- The purchase of an “existing” independent business;
- The purchase of an “existing” franchised business; and
- The purchase and establishment of a “new” franchised business;

While these transactions share may similarities and factors that we will discuss, when your “business transaction” involves an existing or new franchise—as compared to the purchase of an existing non-franchised independent business—there will be an additional layer of franchise related legal issues and business issues
(“franchise factors”) that you must evaluate and understand. These additional “franchise factors” are discussed within the context of each chapter. However, the following is a summary of some key information that you must know about franchise transactions and becoming a franchisee:

**The FDD.**

“FDD” stands for “franchise disclosure document” and represents the legally mandated disclosure document that a franchisor must provide to its prospective franchisees. As a “prospective franchisee”, the franchisor must deliver to you the franchisors then current FDD no less than 14 calendar days prior to the earlier of (a) your payment of any franchise related fees or (b) your execution of any franchise related agreement. The franchisors FDD delivery obligation applies to the sale of a new franchise opportunity but does not apply to a third party transfer or sale of an existing franchised business. However, even if you are purchasing an existing franchise, you should nevertheless—through your attorney—obtain a copy of the franchisors then current FDD and proceed with a due diligence analysis similar to what you would do if you were establishing a new franchised location.

**The franchise agreement.**

When purchasing an existing franchise or the right to establish a new franchised location, the “franchise agreement” will serve as the primary agreement between you (as a franchisee) and the franchisor. The franchise agreement (along with your lease agreement for your business location) will serve as one of the primary
agreements that will govern and define your legal rights and obligations in and to the franchised business that you may be purchasing or establishing. As discussed earlier (Myth No. 5) the terms of your potential franchise agreement are negotiable and should be reviewed and evaluated by an experienced franchise lawyer. Some of the numerous legal rights that must be evaluated in your proposed franchise agreement, include:

- The continuing “royalty” that you will be required to pay the franchisor;
- The method for calculating your royalty obligation;
- Whether or not you will be required to regularly contribute to a national or regional marketing fund;
- The proprietary products and/or services that you will be required to purchase from the franchisor or the franchisor’s designated suppliers and vendors;
- Your rights, if any, to a “protected territory”;
- Your rights respecting the future transfer and sale of your franchise;
- Your obligations upon termination of your franchise agreement; and
- Your obligations respecting confidentiality and non-competition upon termination of your franchise agreement.
What is the purpose of the FDD.

To protect prospective franchisees by providing them with relevant information that should be considered and evaluated before purchasing a franchise. Keep in mind, however, that the FDD is prepared by the franchisor and must be carefully scrutinized and evaluated. When purchasing a franchise the FDD will serve as a significant “life-line” between you and an uninformed and potentially bad business investment. Always discuss and review the FDD with a qualified franchise lawyer and business accountant before making any investment.

What information is included in the FDD.

The FDD is divided into 23 sections (referred to as “items”) and contains information and disclosures about the franchisor, the franchise system offered, the fees that you will be charged, your estimated start-up expenses, your obligations as a franchisee, the franchise agreement, and other franchise related agreements that you will be required to sign.

- Item 1: The Franchisor and any Parents, Predecessors and Affiliates
- Item 2: Business Experience
- Item 3: Litigation
- Item 4: Bankruptcy
- Item 5: Initial Fees
- Item 6: Other Fees
• Item 7: Estimated Initial Investment
• Item 8: Restrictions on Sources of Products and Services
• Item 9: Franchisee’s Obligations
• Item 10: Financing
• Item 11: Franchisor’s Assistance, Advertising, Computer Systems and Training
• Item 12: Territory
• Item 13: Trademarks
• Item 14: Patents, Copyrights, and Proprietary Information
• Item 15: Obligation to Participate in the Actual Operation of the Franchise Business
• Item 16: Restrictions on what the Franchisee may Sell
• Item 17: Renewal, Termination, Transfer and Dispute Resolution
• Item 18: Public Figures
• Item 19: Financial Performance Representations
• Item 20: Outlets and Franchisee Information
• Item 21: Financial Statements
• Item 22: Contracts
• Item 23: Receipts
Initial franchise fee.

The “initial franchise fee” is the initial fee that you must pay to a franchisor when purchasing the rights to establish a new franchised location. The initial franchise fee is almost always a “non-refundable” fee and will be paid by you to the franchisor at the time of signing your franchise agreement. The initial franchise fee is, essentially, a one-time license fee granting you the right to establish the franchised location.

Royalties.

As a franchisee one of your most significant obligations will involve the payment of a continuing and on-going “royalty” to the franchisor. Typically, royalties will be set as a fixed percentage of your “gross sales” and will require payment on a recurring basis such as weekly or monthly. Your royalty obligation will represent one of the most significant on-going / day-to-day expenses that you will incur in connection with the operation of your franchised business. Since royalties are typically based on “gross sales” they are not reduced or influenced by the “profitability” of your business.

Protected territory.

A “protected territory” is a designated geographic area identified and defined in your franchise agreement wherein you may be granted the exclusive right to establish and operate your franchise. When a protected territory is granted, typically, the franchisor will agree to prohibit other franchisees from operating and establishing a competing franchise within the designated territory. The protected territory only applies to competition from franchisees within your
own franchise system and will not protect you from third-party competitors.

Many franchisors and franchise systems do not offer a protected territory to their franchisees. Although—from a franchisee perspective—it would always be preferable to possess a protected territory, under “certain circumstances” it may not be practicable or reasonable to expect one. Issues concerning the negotiation and potential implementation of a protected territory should be of critical concern to you and should be discussed and evaluated with your franchise lawyer. When considering and evaluating the existence and/or non-existence of a protected territory, some factors to consider, include:

- The franchisor’s history and prior practices respecting the establishment of franchised locations. For example, are existing franchisees satisfied with the franchisors policies and procedures for granting and locating new franchises, or, do they complain about “encroachment” and diluted sales resulting from over-expansion.

- The scope of your protection within the defined “protected territory”. This is an important issue that is too often overlooked and an issue that should be of particular concern when purchasing a franchise that provides “services”. When purchasing a service-based franchise—as opposed to a franchise that simply sells a product from a fixed location—you must evaluate the scope of the protections that will be granted to you within your protected territory. Although competing franchisees may be prohibited from establishing
a storefront or physical location within your territory—
depending on the terms of your franchise agreement—
competing franchisees may nevertheless be permitted to
solicit or provide services to customers located within your
territory.

- Potential competition from non-traditional locations and
  “captive accounts”. To the extent that you are afforded a
  “protected territory” you must be aware that in the majority
  of franchise agreements one significant exclusion from
  the “exclusivity rights” associated with a protected terri-
tory relates to the franchisor's ability to establish and grant
competing franchises within “non-traditional” or “captive
market” locations—even if they are located within your
protected territory. Examples of non-traditional or captive
market locations, include universities, airports, stadiums,
arenas, malls and, supercenters. When evaluating your pro-
posed business location and your protected territory, eval-
uate the existence of non-traditional locations within your
territory and the potential impact that competition from
these locations may have on your new business.

**Franchise term.**

The “term” of your franchise agreement relates to the fixed
period of time during which you will possess the right to own and
operate your franchised business. Once the “term” of your franchise
agreement expires you will be required to either terminate the oper-
ations of your franchised business or negotiate the renewal of your
franchise rights. Although the “term” of a franchise opportunity will
vary between franchisors and franchise opportunities, franchisors typically grant franchise rights for a period of ten (10) years. The term of your franchise agreement should correspond to the “term” of your lease agreement and should be for a period of time sufficient for you to recoup your investment in the franchise and generate a sufficient rate of return on your investment.

The foregoing “franchise factors” represent some of the legal issues that you should be aware of when purchasing a franchise. In the remaining chapters of this book we will be evaluating business purchase transactions, the components of a business, the due diligence process, the process of closing a business purchase transaction and some critical mistakes to avoid. These topics—and the remainder of this book—apply to both independent and franchised businesses. They apply, to a lesser extent, to prospective franchisees that are looking to establish a new franchised location—as opposed to purchasing an existing store. However, even if you are investing in and establishing a new franchised location I can assure you that the information contained in the remaining chapters of this book will be critically important to your understanding of your franchise transaction and the “mindset” that you must bring to the table when investing in a franchise. Within the remaining chapters of this book I have separately identified the additional “franchise factors“ that you should be evaluating.

In the Supplement to this book I have included additional “franchise information” in the form of specific articles addressing critical factors and information that prospective franchisees must be aware of.
An Entrepreneurs Guide to Purchasing a BUSINESS or FRANCHISE

A Practical No Nonsense Guide to Educate, Inform and Empower Business Purchasers and Prospective Franchisees
What Is A Business?

This question is important, and, most significantly, the answer will be critical to your understanding and evaluation of your business purchase or franchise transaction. From a business or franchise purchaser’s perspective the short answer to this question is that a “business” is nothing other than the combination of its “tangible assets”, “property interests” and “goodwill”.

\[
\text{Tangible Assets} + \text{Property Interests} + \text{Goodwill} = \text{BUSINESS}
\]

From a business or franchise purchaser’s perspective, understanding the basic components of a business is an important starting point for properly evaluating and assessing your business transaction. In this chapter we will discuss each of these “business components” in some more detail starting with “tangible assets” and followed by “property interests” and “good will”. Within each section of this chapter and the following chapters we will discuss some of
the important factors and special considerations that you should be aware of when evaluating the assets of a business, including the significance of identifying tangible assets, initial questions that you should be asking about a business lease, why your franchise agreement is an asset, and understanding what “goodwill” is and how it is protected. These issues are discussed within this chapter and the following chapters on due diligence.

**Tangible assets.**

The “tangible assets” are the physical/“hard” assets that a business uses each and every day. The “tangible assets” of a business are typically categorized as furniture, fixtures or equipment and the precise nature of these tangible assets will depend on the particular business and the industry in which it operates. When purchasing an existing independent or franchised business you must start off with a basic identification of the “tangible assets” and obtain a clear understanding as to whether or not these assets are either owned by the seller or leased and whether or not these assets will be transferred to you free and clear of any liens or leasehold obligations of the seller. In the following chapters we will discuss, in more detail, the due diligence factors that you should be aware of when evaluating the tangible assets of a business.

If you are establishing a new franchise location, you will be directly acquiring and purchasing the tangible assets for your business. Prior to purchasing the franchise you must obtain a clear understanding about the tangible assets that you will be required to purchase and the cost to purchase these assets. The franchisor should possess a list of these assets and their estimated cost. Significantly, the Item “7” of the franchisor’s FDD should contain a summary of
your estimated initial investment to establish your franchise and will include “estimated costs” for your furniture, fixtures and equipment.

To verify the franchisor’s representations as to tangible asset purchases and their cost, you should contact the franchisor’s designated suppliers and existing franchisees.

**Property interests.**

“Property Interests” relate to the legal rights of the business or franchise that you are purchasing. The most critical of this “interests” and rights relate to (a) the lease agreement respecting the location of the business and, for franchises, (b) the rights granted in your franchise agreement or the franchise agreement of the business that you are purchasing.

**Real property lease.**

Critical to almost every business and, most likely, the business that you may be purchasing is the business’s location and available facilities. For a retail business, location is probably one of the biggest factors that will influence your success. If you have already identified a business that you are interested in purchasing, you are aware of the businesses location and, I would assume, that the location is a key component to the business and a reason why you may interested in purchasing the business. Naturally, businesses such as restaurants, car washes, learning centers, laundromats, convenience stores, gas stations and many others are largely dependent upon their current location. Without their current location, these businesses would lose a significant portion of their customer base and revenue.
Now that I have discussed the obvious, *i.e.*, “that location is critical”, from a legal standpoint, as a potential purchaser, you must determine and evaluate whether you will be either (a) leasing the property where the business is located, or (b) purchasing the property where the business is located.

The typical business purchase transaction involves a “leased” business location that will be obtained through either (a) the assignment of the Sellers lease, *i.e.*, where the seller of the business does not own the property and the seller, as a tenant, will assign its lease to you as the purchaser of the business or (b) the execution of a new lease agreement directly between you and the landlord. To do this, a Seller will require the consent of the landlord. As a purchaser, at the outset of evaluating a business, you must evaluate the terms of the existing lease and determine the minimum guaranteed lease term, payment obligations and requirements necessary to ensure that your investment in the business will generate a sufficient rate of return.

As a “business or Franchise Purchaser” your prospective business lease will constitute one of your most important assets. When evaluating your prospective business lease some of the “initial” questions and concerns that you should evaluate, include:

- The remaining term / number of years left on the lease;
- The existence of renewal terms under the lease, or, the possibility of extending the lease term;
- The fixed base monthly rent;
- Additional rent obligations—in addition to fixed monthly rent—that you will be required to pay, such as, property
taxes, maintenance charges, utilities and common area charges;

- Restrictions in the lease prohibiting the landlord from leasing space to a competitor—this is especially important if your business is located in a mall or shopping center;

- If the lease is in a shopping mall are there additional rent charges based upon a percentage of your monthly or annual revenues; and

- Whether or not you will be personally obligated to guarantee terms of the lease, including the payment of past due rent and future rent obligations.

If your business transaction does not involve a lease but, rather, the “purchase” of real estate, then, as a purchaser, you will be engaged in two very distinct transactions. The first transaction involving the purchase of the business and the second involving the purchase of real estate. As to each type of transaction there will be unique business and real property due diligence factors that must be evaluated.

In the Due Diligence chapter of this book, we will review additional factors that should be considered when evaluating a your prospective business lease.

**Franchise agreement.**

When purchasing a franchise—either an existing franchise or a franchise location that you will be establishing—one of the primary “property rights” and business interests that you will be
acquiring are the rights granted to you in your franchise agreement. The value of these “franchise rights” will be difficult to assess and will require a thorough analysis of:

- The experience of the franchisor;
- The franchisor’s practices for training its franchisees;
- The franchisor’s practices for providing on-going training and support;
- The franchisor’s practices for continued product development;
- The industry in which the franchise will operate;
- Consumer recognition of the franchise’s products and services;
- Consumer recognition of the franchise’s trademarks and trade dress;
- The rights granted to you in the franchise agreement;
- The obligations that will be imposed on you, as a franchisee, in the franchise agreement; and
- Franchisee profitability.

Although the foregoing factors are generalized descriptions, they are nevertheless key criteria for franchisee success and “pieces of a due diligence puzzle” that you must evaluate and consider. No one factor is more important than the other and, prior to making a franchise investment, you must insure that these factors are properly
balanced to maximize your chances for success. From a legal perspective, it is critical to insure that you balance, as a prospective franchisee, both, the “legal rights” that you will be acquiring and the “legal obligations” that you will be undertaking. Understanding your franchise agreement and the disclosures contained in the FDD will be critical and should be the starting point for your investigation. Initial questions about your franchise agreement should include:

- The term/number of years of the franchise agreement;
- The existence of renewal terms under the franchise agreement;
- Estimated start-up expenses;
- The franchise fee;
- The fixed royalties that you will be required to pay on a weekly or monthly basis;
- The advertising fund fees, if any, that you will be required to pay on a regular basis to support regional or national advertising and media; and
- Whether or not you will be provided a “protected territory”.

In the due diligence chapters of this book we will discuss these factors in more detail. However, for the purpose of this chapter—understanding the assets of a business—it is critical to recognize that (a) your franchise agreement (and the rights granted to you as a franchisee) should be evaluated as a business asset, and (b) the value of your “franchise agreement asset” will depend on the quality of the
franchisor, the franchise system, the terms of your franchise agree-
ment, and the obligations imposed on you as a franchisee.

**Goodwill.**

The term goodwill has special accounting and legal signifi-
cance but, from a business purchaser’s perspective, goodwill, basi-
cally, refers to the intangible earning power of the business—sort
of the key ingredient that makes a business special and, hopefully,
profitable.

Although this goodwill asset is “intangible”, it is nevertheless
real and must be properly identified. When identifying this asset,
recognize that you should be evaluating and assessing all factors
that make the business unique or gives it a competitive advantage.
When dealing with franchise transactions—especially when you are
starting up a new franchised location—recognize that much of the
businesses goodwill will be associated with the franchisor’s existing
systems, trademarks, trade dress and industry reputation. Examples
of goodwill:

- Customer lists;
- Information about prior customer purchases;
- Mailing lists;
- Trademarks, trade names and trade dress;
- Custom software utilized by the business;
- Special recipes or production methods;
- Special or unique telephone numbers and domain names;
• Specialized employees.
• Non-Compete agreements.
• Customer contracts.
• Exclusive supply agreements.

Rights granted in a franchise or license agreement. These rights must be evaluated within the context of your “obligations” as a franchisee. Your overall evaluation should include an assessment of your royalty obligations to the franchisor and whether or not the value of the goodwill afforded to you as a franchisee outweighs the royalties and fees that you will be required to pay the franchisor on an ongoing basis.

The foregoing are just a few examples of the numerous potential “goodwill” assets that may be associated with the business that you are purchasing. The value of these intangible assets will vary substantially from business-to-business and will require an assessment of both their “legal” and “business” value. As to these assets, you must:

• **Identify.** Identify the intangible assets that add value to the business and serve as goodwill;

• **Evaluate.** Discuss with your attorney whether or not these intangible assets have been properly preserved. For example:
  - Have customer lists been maintained as confidential;
  - Have the trademarks been registered;
- Does the business maintain valid license agreements for specialized and proprietary software systems;

- Will key-employees continue with their employment and will they agree to future employment and a confidentiality agreement;

- Are existing customer agreements valid and enforceable; and

- Are vendor and supply agreements valid and enforceable.

**Protect.** Discuss with your business attorney how to protect these intangible assets. For example, if a business relies on the specialized skills of a key employee, a recognized business name, trade secret or patent, you must discuss these issues with your business attorney and put into place legal protections for these assets.

If the business is a franchise then you must recognize that the goodwill associated with your franchised business will, in large measure, be developed and controlled by the franchisor and will be regulated and governed by the terms of your franchise agreement. It is important that you understand the terms of your franchise agreement and the restrictions placed on your business assets, advertisements and restrictive covenants that you may be subject to upon the termination or expiration of your franchise agreement.

The following are some examples of goodwill and the legal provisions that should be considered in the negotiation of your asset purchase agreement:
- **Customer Relationships**

  **Legal Protection:** Non-Competition Covenant

  Since the seller’s individual shareholders/owners know the business better than anyone else and will possess relationships with customers and suppliers that you will depend on, it is critical that your purchase agreement and closing documents include “non-competition covenants” prohibiting the seller (including, the seller’s individual shareholders) from establishing, managing or operating a business that will compete with you in the future. An acceptable non-competition covenant must precisely, clearly and fairly define a specified duration (during which the seller and the seller’s shareholders are prohibited from competing) and territory (in the form of a set radius of “miles” from the location of the business that you are purchasing) prohibiting the seller and the seller’s individual shareholders from competing with you or diverting your customers to a third party.

- **Specialized Employees**

  **Legal Protection:** Non-Solicitation Covenant

  If the business that you are purchasing relies on specialized skills of key employees of the seller, while you cannot force the seller’s employees to continue to work for you, you can prohibit the seller from employing or soliciting these employees for a new business venture or on behalf of a third party competitor. If drafted properly, the “non-solicitation covenant” will create a binding legal
obligation prohibiting the seller (and the seller’s individual shareholders) from interfering with the continued employment of your new employees. As a business attorney, I find that in too many instances non-solicitation covenants and protections are often overlooked and not included in purchase agreements.

- Trademark/Trade Name

**Legal Protection:** Trademark Assignment and Registration

To protect this asset, your asset purchase agreement must provide for the express transfer of the business name / trademark from the seller to you, the purchaser. Likewise, there should also be a clear transfer of rights as to the seller’s telephone numbers and internet domain addresses.

When dealing with trade names and trademarks, a purchaser should always discuss with his or her business attorney whether or not the trademarks are registered with the United States Patent and Trademark Office and, if not, whether or not registration may be accomplished at a later date.

If the business that you are purchasing or establishing is a franchise then you will not be acquiring an ownership interest in the Franchisor’s trademarks. However, as a franchisee, you will be granted the right and license to utilize the franchisors trademarks. It is critical that you discuss with your attorney the rights granted to you in the franchise agreement and whether or not the franchisor’s
trademarks are registered with the United States Patent and Trademark Office.

- **Customer Lists**

  **Legal Protection: Customer List Transfer and Confidentiality**

  The purchase agreement should provide for the express transfer of all customer lists and customer names to the purchaser. To prevent the disclosure of this information by the seller to third parties or for use by the seller, the purchase agreement must include confidentiality, non-competition and non-solicitation clauses. What does this do? It prohibits the seller from establishing a competing business and prohibits the seller from using the customer information for another business venture or for the benefit of a third party.
Due DiLiGence anD The TiMinG Of The Due DiLiGence PrOcess

Due Diligence = Investigate the Business and Understand what you are Buying

Due diligence.

For the first time business or franchise purchaser “due diligence” is critical. Although the term “due diligence” may sound odd or out of place, it simply refers to the “pre-purchase/pre-investment investigation” that you must undertake before signing a purchase agreement or franchise agreement. As a prospective business or franchise purchaser you must approach “due diligence” as a constant and continuing information gathering and evaluation process respecting each and every aspect of your prospective transaction. This process should include active consultations and discussions with your attorney and business accountant and involve your evaluation and assessment of the businesses assets, comprised of (a) the tangible assets, (b) property interests, and (c) goodwill.

At the conclusion of your due diligence investigation and evaluation, you must answer two critical questions:
1. Are you paying a fair price (one that will generate an acceptable rate of return) for the business or franchise that you are purchasing; and

2. Do you have a thorough understanding of the business assets and legal rights that you are acquiring and the legal obligations that you are assuming—including your potential rights and obligations as a franchisee. Keep in mind that your “investment” in a business or franchise requires an ongoing obligation that will require your investment of time, resources and, potentially, additional capital.

In the remainder of this chapter we will review various aspects of the due diligence process, including:

- Timing of the Due Diligence Process;
- A sample due diligence contingency clause;
- Due diligence factors to consider when evaluating “tangible assets”;
- Due diligence factors to consider when evaluating “property” interests;
- Special Due diligence factors to consider when purchasing a franchise; and
- Due diligence factors to consider when evaluating “goodwill”.
Timing of the due diligence process.

As a business or franchise “purchaser” you should be constantly gathering and evaluating information respecting the substantial investment that you are about to make. Although “due diligence” takes time and should not be rushed, the “business reality” is that the timing of the negotiation process during which you will be required to evaluate and determine whether or not to enter into a contract may be compressed and be of an insufficient duration to permit your completion of this critical task. During the course of negotiations—typically occurring just prior to signing a binding contract—your opportunity for due diligence will end and you will be required to either commit to or walk-away. So how do you achieve balance between your need to complete a thorough and necessary evaluation and the business reality that—prior to signing a binding contract—you may not possess sufficient time to complete your investigation? You speak to your lawyer about a due diligence contingency.

When conducting your due diligence investigation balance must be achieved between a seller’s desire to maintain the confidentiality of his or her business information (sellers are especially concerned about unqualified purchasers and prospective purchasers that are just “tire kickers” or, worse, competitors pretending to be a potential purchaser) and a purchaser’s need to verify and evaluate the seller’s information. To achieve this balance, as a purchaser, you will be faced with constant pressure from the seller to sign a purchase agreement and you will be left with the question of: “how do I agree to a contract without first verifying the seller’s financial information and completing my due diligence evaluation”. If you cannot
complete your due diligence prior to contract signing (a difficult task that will require active communications with your business accountant and business attorney) the most practical solution—a solution that best protects the interest of a purchaser—is to proceed with signing a purchase agreement (thereby inducing the seller to release his or her information) that includes a “Due Diligence Contingency Clause.” A due diligence contingency is a legal provision inserted into your purchase agreement that identifies a set time period during which you, as the purchaser, will be given access to the seller’s books, records and business operations and be given an opportunity to complete your due diligence investigation and assessment. If, during the defined due diligence contingency period, you do not like what you have seen, you will be given the opportunity to cancel the contract. The mechanics of “due diligence contingencies” vary between various parties and lawyers and the rights that you may or may not possess will depend on your negotiations and how your attorney defines and drafts the exact language of your purchase agreement.

If the seller will not agree to a due diligence contingency, then your evaluation must be completed prior to signing and obligating yourself to the purchase agreement. To better understand the nature of a potential “due diligence contingency” I have included the following sample “due diligence contingency” clause that I sometimes negotiate and include in purchase agreements:
Sample Due Diligence Contingency Clause

Due Diligence Contingency. Purchaser and Seller acknowledge and agree that Seller makes no representations respecting the financial performance of the Business. Seller acknowledges that Purchaser wishes to enter into this Agreement but requires additional time to complete Purchaser’s own due diligence review to determine Purchaser’s own satisfaction of the Business. Accordingly, Purchaser and Seller acknowledge that commencing for ____ days following the date of this Agreement (the “Due Diligence Review Period”) Purchaser shall have the ability to review and visit the Business Premises (provided that Purchaser does not interfere or disrupt the operations of the Business) and review materials and financial information requested by Purchaser from Seller. Seller reserves all rights as to what Seller agrees or elects to disclose. If at any time during the Due Diligence Review Period, Purchaser, for any reason or no reason at all, elects not to proceed with this transaction than Purchaser may cancel this Agreement by a written notice to be forwarded to both Seller and Seller’s attorney. Such notice must be submitted by both Federal Express (overnight delivery) and certified mail to both Seller and Seller’s attorney. Said notice of termination must be postmarked and mailed (in the case of the Federal Express than delivered to a Federal Express agent) during or within the Due Diligence Review Period and not after. If Purchaser timely terminates this Agreement pursuant to the terms of this Section. Purchaser shall be entitled to the return of the Contract Deposit whereupon Purchaser and Seller shall have no further rights and obligations between one another except that all information and documents supplied to Purchaser by Seller shall be returned to Seller and Purchaser shall remain under the obligation to maintain the confidentiality of the information disclosed to Purchaser during the due diligence process.
As a purchaser it is critical that you coordinate your due diligence efforts with your business attorney and business accountant. Although your business attorney is not qualified to advise you as to the valuation of the business, he or she must nevertheless be involved in the valuation process to insure that you possess sufficient time to complete your evaluation and to ensure that the purchase agreement accurately reflects and protects the business assets that you are purchasing. *For example*, if your assessment is that an extension of the business lease term is a key component to the agreed upon purchase price, your business attorney must insure that the purchase agreement accurately and adequately addresses this criteria.

If your due diligence is not completed prior to contract signing, then your business attorney must consider and negotiate the inclusion of a “due diligence contingency” into your purchase agreement.

**Due diligence when purchasing a franchise.**

If the business that you are purchasing is a franchise, then you will be presented with additional due diligence factors and considerations that must be evaluated. As a prospective franchisee you must recognize that in addition to your “purchase transaction”—if you are buying an existing franchise—you will also be entering into a “franchise transaction” comprised of a contractual relationship with the franchisor that must be thoroughly assessed, evaluated and, potentially, modified. The primary asset and informative tool that you will possess will be the disclosures contained in the franchisor’s FDD and, potentially, discussions that you may have with existing franchisees.
Throughout this book we discuss the various facets of a franchise relationship and in the following due diligence chapters, where applicable, we will discuss additional due diligence factors that should be considered by prospective franchisees. Issues concerning “franchisee due diligence” are further discussed in additional detail in the “Supplement” chapter of this book.
3

Tangible Assets: Due Diligence Factors to Consider

When evaluating the “tangible assets” of a business, as a prospective purchaser, a basic starting point should involve an on-site inspection and a review of the seller’s written list of assets. The list of the seller’s assets should be confirmed during your on-site visual inspection. After the assets have been properly identified you should physically inspect the condition of the assets and, for specialized and complex equipment, it is recommended that you hire a technician to inspect the condition of the equipment, assess the functionality of the equipment and evaluate the remaining useful life of the equipment. Once the identification and physical inspection of the seller’s tangible assets are completed, you must discuss and review with your business lawyer the seller’s ownership interests in these assets and the possible existence of liens or other obligations that may restrict the seller’s ability to transfer its tangible assets.

It is important to note that when dealing with specialized equipment that may be subject to environmental or government regulation such as dry-cleaning equipment, car wash systems and many types of manufacturing equipment, as a purchaser you must ensure that the equipment complies with “current” regulations. Always consider that when dealing with equipment that is subject to environmental and/or safety regulations, it is not enough for the
equipment to simply “function” but rather to be “functional and comply” with applicable regulations. Inquire with local trade organizations and government entities to evaluate current regulations and, possibly, costly regulations that may be implemented in the future.

**Tangible assets: due diligence factors to consider:**

- **Asset Identification.** The tangible assets and equipment utilized by the Seller in the operations of the business;

- **Physical Condition.** The physical condition and remaining useful life of the seller’s assets and equipment;

- **Existence of Liens and Leases.** Whether or not the seller owns the tangible assets outright or subject to a lien or lease obligation. If the assets or equipment are leased, the Seller’s lease obligations must be clarified and the purchase agreement must specify whether or not the assets will be transferred free of the lease (*i.e.*, whereby the seller pays off the lease obligations and acquires title to the assets at or prior to closing) or if the purchaser will be required to assume the seller’s lease obligations (*i.e.*, monthly payments) after closing. As to the existence of liens on the assets and equipment, your business attorney will order various lien and judgment searches to ensure that, at closing, there are no recorded liens on the assets and equipment;

- **Regulatory Compliance.** Whether or not the Seller’s physical assets and equipment are subject to government regula-
tion requiring modification or replacement to comply with current or new regulations;

- **Inventory.** Whether or not “inventory” is included in the purchase agreement as an asset to be transferred and purchased by you. If inventory is included in the purchase price, the purchase agreement must specifically identify the inventory to be included and the valuation (relative to the overall purchase price) of the inventory. Typically, the purchase agreement should include a clause requiring the seller to replenish and maintain the normal levels of inventory so that, at the time of closing, there is an adequate level of inventory to continue the operations of the business. The inventory should be reviewed and “counted” on the evening or day prior to closing.

**Tangible assets: additional due diligence factors to consider**

When the business is an “existing franchise”

- **Restrictions on Transfer.** Whether or not the assets being purchased are branded with the franchisors trademark(s). If so, your ability to transfer or sell these assets in the future may be restricted and your use of these assets may be limited to only your operation of the franchised business that you are purchasing;

- **Restrictions of Use.** Whether or not the assets being purchased are considered specialized and “proprietary” equipment utilized by the seller (and eventually you as the purchaser of the business) exclusively in connection with
the operations of the franchised business such that upon expiration or termination of the franchise agreement the seller (and now you as the purchaser of the business) will no longer possess the right to utilize such equipment.

- **Franchisor Approval.** Whether or not the franchisor has approved the sale of the business and has consented to the transfer of the seller’s franchise agreement to you as the purchaser and, soon to be new operator, of this franchised business.

**Tangible assets: additional due diligence factors to consider**

**When the business is a “new franchised location”**

If your contemplated business transaction does not involve the purchase of an existing business of franchise but, rather, your establishment of a new franchise location you will be presented with a unique set of due diligence factors to consider. Basically you will be starting from scratch and your most significant source of information will come from the Franchisors FDD – Franchise Disclosure Document. Factors to consider, include:

- **Franchisor’s Estimated Initial Investment.** In “Item 7” of a franchisor’s FDD, franchisors are required to disclose to you (a prospective franchisee) an estimate of your “initial investment”. Included in the franchisors FDD Item “7” disclosure should be a break down of estimated expenses, including “tangible assets” that you will be required to purchase. These tangible assets include furniture, fixtures and
equipment and should contain detailed information such as the approved vendors that you will be required to purchase the assets from. You should review the FDD with a franchisor lawyer and your accountant.

- **Point of Sale Systems.** As a franchisee, most likely, you will be required to purchase a computerized point of sale system. Although these systems are a form of equipment disclosed in Item 7, you should be aware that these systems (and their expense) are many times overlooked by new franchisees. Review the Item 7 FDD disclosure in detail to identify and assess the point of sale systems that you will be required to purchase.

- **Contact Existing Franchisees.** Your franchisors FDD Item 7 initial estimate disclosure, most likely, is only an “estimate” and, most likely will be subject to significant variation. One method for auditing and evaluating the estimating contained in the FDD should include the basic task if containing existing franchisees and inquiring about the actual initial investments that they incurred on their behalf as to the accuracy of Item “7”. Existing franchisees possess a wealth of information and experience that you may benefit from—contact them.
As discussed in Chapter 1, the primary “property interests and rights” that a business purchaser must evaluate and assess include the legal rights associated with (a) the lease agreement respecting the location of the business and, (b) for franchises, the franchise agreement. Both agreements—and the legal rights and obligations associated with each of them, respectively—will have a substantial impact on the day-to-day operations, profitability and long-term success of your business. As to each agreement you must conduct—with your attorney—a thorough due diligence evaluation whereby you:

- Understand the legal “rights” that you will be acquiring;
- Understand the legal “obligations” that you will be assuming;
- Assess the value and/or cost of these legal “rights” and “obligations”; and
- Legally secure and protect your long-term legal interests in each agreement.
Real property interests.

As to the real property utilized by the Seller in the operations of the business, a purchaser’s due diligence evaluation will depend on whether or not the purchaser will be acquiring (a) a “leasehold” interest in the property, i.e., where you will be a tenant pursuant to the terms of a lease, or (b) an ownership interest in the property where you purchase and acquire title to the real property where the business is located.

Leasehold interest.

When dealing with a leased business location your due diligence evaluation will vary depending on your particular transaction and the method by which you intend to acquire your leasehold interest. The acquisition of your leasehold interest will, most likely, be derived under one of the following two circumstances:

1. **Assigned Lease from the Seller** – If you are purchasing an existing business from the seller of a non-franchised business the most common method by which you will obtain your “leasehold interests” will be by lease assignment that is, the seller will assign his or her interests in the lease to you and you, as the assignee, will become the new tenant under the business lease; or

2. **Direct Lease from Landlord** – A direct lease involves the drafting and negotiation of a new lease agreement between you, as tenant, and the landlord. This process bypasses an assignment of the sellers existing lease. If you are not purchasing an existing business but rather starting a new
franchise location then your lease negotiations and agreement will be between you and the landlord directly. Some of the critical due diligence factors that you should consider when evaluating a lease and the leasehold interests that you may be acquiring, include:

**Lease agreement: due diligence factors to consider**

- **Term.** The term of the lease/remaining time period left on the lease;

- **Term Extension.** The likelihood of obtaining an extension of the lease term and the legal protections, if any, that may be incorporated into your lease or lease assignment agreement;

- **Permitted Use.** The “use” clause contained in the lease—this clause states the type of business and activities that may or may not be conducted at the leased location;

- **Base Rent.** The agreed upon current base monthly rent;

- **Rent Increases.** The scheduled annual increases in the base monthly rent;

- **Additional Rent.** Whether or not the lease requires additional monthly charges for building maintenance;

- **Taxes.** Whether or not the lease requires additional monthly charges for real estate taxes;
• **Utilities.** Whether or not the lease requires additional monthly charges for utilities;

• **Utility Meters.** Whether or not the leased premises includes separate meters to measure your use of water, electric and other utilities;

• **Sprinkler Systems.** Whether or not you will be required to install or maintain sprinkler and fire suppression systems;

• **Insurance.** The type and amount of liability insurance that the landlord requires;

• **Improvements.** Your right and ability to modify and improve the leased premises;

• **Repairs.** Whether or not you are required to maintain and pay for the repair of structural elements of the leases premises;

• **Parking.** Your rights (and the rights of your customers/clients) to utilize parking facilities or space controlled by the landlord;

• **Competitors.** Whether or not the lease prohibits the landlord from leasing space to a competitor—this is especially important when the business is located in a strip center or mall;

• **Guaranty.** Whether or not the lease requires that you personally guaranty the lease. For example, even though you will be purchasing the business through a corporate entity,
some landlords will still require that you, individually and personally, guarantee the lease. If you are required to personally guarantee the lease, you must discuss with your business attorney the possibility of limiting your individual obligations and guaranty. Ask your attorney about limiting your personal guaranty with what is known as a “good guy clause” that will, basically, limit the scope and duration of your personal guaranty;

- **Environmental Inspection.** Depending on the duration of the lease and your obligations respecting the maintenance of the leased property, it may be recommended for you to retain a licensed professional to inspect the premises for environmental contamination and to provide an initial assessment and evaluation of the seller’s compliance with applicable environmental regulations. Typically, this initial assessment is known as a “Phase I Environmental Site Assessment”. This initial assessment will review the history of the property and provide you with preliminary findings as to possible contamination. Depending on the results of the “phase 1” study additional studies may be required.

**Lease agreement: additional due diligence factors to consider when the business is a franchise**

- **Sublease.** Franchisors typically, look to assert and maintain control over a franchisees business location. One method that a franchisor may utilize to obtain control is to structure your lease as a sublease whereby the primary lease agreement
is between the landlord and the franchisor directly. Your rights (as a franchisee) to the leased premises is then derived from a “sublease” between you and the franchisor. So, when purchasing an existing franchise or establishing a new franchised location it is important that you determine and discuss with your franchise lawyer whether or not the lease for the business premises is transferred/issued to you directly (as the purchaser of the business and the new franchisee) or if the lease will be by the franchisor (as the direct tenant) and then to you, indirectly, as a subtenant. This is important because in instances where the franchisor has direct control of the lease, it is possible—if you breach or terminate the franchise agreement—for the franchisor to “step in” and take over the operations of your business. Although this is a drastic remedy for the franchisor, keep in mind that if your franchise agreement is properly negotiated, this concern only should come about in instances where you breach the terms of the franchise agreement;

- **Lease Management Fee.** Whether or not the franchisor charges a monthly lease management fee. This applies mostly in instances involving the franchisor’s sublease of the business location and constitutes, typically, an administrative monthly fee charged to you by the franchisor for being identified as the direct tenant on the lease;

- **Restricted Use.** Whether or not the leased business location may be converted to a non-franchised business location in the event of a termination of the franchise agreement; and
**Protected Territory.** Whether or not the franchise agreement includes a protected territory (i.e., a specified geographic radius or map located within a certain proximity to the business location) within which the franchisor will not sell any additional franchises.

**Ownership interest—purchasing the underlying property.**

If the underlying property is owned by the seller and you are purchasing the property, you will be faced with significant issues inherent to all real estate transactions ranging from valuation of the property, inspection of buildings, improvements, title searches, title insurance and closing. As you are aware, there are numerous and extensive issues respecting the purchase of real property. Most of these issues go beyond the scope of this book and require active consultation with your business lawyer who your must insure is experienced in real estate transactions. Without addressing the numerous issues inherent in all real estate transactions, with regard to the “business” aspect of your transaction and the interaction of the business and property that you will be purchasing, you should consider and evaluate the following factors:

**Purchase of real property: due diligence factors to consider**

- **Zoning.** Whether or not the current zoning (permitted by the local township, city or governing entity) as to what activities and business may be conducted on the property, permits commercial activity and/or industrial activity that includes the seller’s current and anticipated business activities and operations;
• **Environmental Inspection.** Whether or not the property complies with applicable environmental regulations and whether or not the property has been exposed to environmental contamination. Prior to purchasing or committing to purchase a commercial property, to reduce the substantial exposure and financial risk of purchasing a contaminated property, as a purchaser, you must obtain an environmental assessment from a licensed professional. Typically, the initial assessment is known as a “Phase I Environmental Site Assessment”. This initial assessment will review the history of the property and provide you with preliminary findings as to possible contamination. Depending on the results of the “Phase 1” study additional studies may be required;

• **Cross-Defaults.** That your business purchase agreement and your real estate purchase agreement include “cross-default” provisions stating that if one agreement is cancelled then the other agreement is also automatically cancelled. This is important because if the business transaction “falls through”, more likely than not, as a purchaser, you will no longer have any interest in the underlying property; and

• **Valuation.** That the real estate that you are purchaser is identified separately from the business with a clear identification of the value of the purchase price allocated to the real estate. This is important since, typically your real estate investment will not serve as a “depreciable asset” that will
serve to lower your tax burden and tax obligations during the life of your business.

**Franchise agreement: legal interests as a franchisee.**

As discussed in the preface chapter iii of this book, “Franchise Factors: A General Overview of Franchise Transactions”, when purchasing an existing franchise or the right to establish a new franchised location, your “franchise agreement” will serve as the primary agreement between you (as a franchisee) and the franchisor. The franchise agreement (and the rights contained therein) will serve as one of your primary “business assets” and, in terms of asset classification, may be characterized as both a “property interest” and “goodwill/intangible” asset. Irrespective of the asset classification, as a prospective franchisee, it is critical that you thoroughly assess and understand, as a franchisee, the legal rights that you will be acquiring and the obligations you will be undertaking. To do this your starting point should be with an examination of the disclosures contained in the FDD and the content of the proposed franchise agreement.

The due diligence factors that you should be considering respecting the legal interests that you will be acquiring and assuming are discussed in more detail in this book in the preface Chapter iii and Chapter 5 that follows. Also the Supplement to this book contains a number of articles focused on franchisee due diligence.
The goodwill of a business—that is, the intangible asset or assets that contribute to the income and earnings potential of a business—is the most important and difficult asset to value. In evaluating this intangible asset you will, essentially, be evaluating:

1. The earning potential of the business,

2. Whether or not the purchase price is a “fair price”, and

3. The potential rate of return that you may earn on your investment.

In many instances—as to many facets of this evaluation process—you will be relying on subjective assessments and criteria. Due to the subjective nature of this process it is critical, as a purchaser, to collect as much information about the business, participate in the businesses operating activities and review the financial records and information with your business accountant and, if necessary, an accredited business appraiser. At each stage of this valuation process, your business attorney must coordinate with your accountant and/or valuation professional to ensure that you possess the appropriate due diligence opportunities and options in your purchase agreement.
If the business that you are purchasing or starting is a franchise, one significant “due diligence” resource that you must consider is the opinion of existing franchisees. In “Item 20” of every FDD franchisors are required to disclose information about their existing franchisees. Review the disclosed franchisee information and make every effort to contact these franchisees and discuss their experiences in the franchise system. Existing franchisees possess a wealth of information—so ask questions.

As to the income and earnings potential of a business, among many other factors to be recommended by your business accountant or valuation expert, a purchaser should consider and obtain information as to:

**Financial performance: due diligence factors to consider**

- **Income and Gross Revenue – Financial Statements.** The gross revenue and net income reported on prior year financial statements;

- **Gross Revenue – Tax Returns.** The gross revenue and net income reported on prior year tax returns;

- **Accounting Journals.** The gross revenue, net income and expenses recorded by the business on the seller’s internal accounting journals, books and records;

- **Sales Tax Returns.** Sales tax reports, records and returns filed in prior years;
• **Officer Compensation.** Officer compensation—typically the salaries paid to the shareholders/owners of the selling corporate entity—reported on prior year tax returns;

• **Customer Concentration Levels.** The concentration levels of the seller’s clients/customers. For example, is the seller’s business comprised of a large number/high volume of customers that each account for a small percentage of overall sales or a small number/low volume of customers that account for a large percentage of the seller’s overall sales. In the latter scenario (where the seller possesses a small number of customers that account for a large percentage of overall sales) additional due diligence is required to ensure that the relationships with these customers are stable and will not be disrupted by a sale of the business to you. Additionally, in this scenario, it is extremely important that your business attorney properly negotiate, draft and incorporate into your purchase agreement solid non-compete and non-solicitation covenants preventing the seller from interfering with these accounts/customers after closing;

• **Invoice Analysis.** Whether the seller’s accounts payable and purchase invoice receipts for inventory and suppliers match the level of activity and sales reported in the seller’s financial statements and tax returns;

• **Caution: when Seller Operates Multiple Locations.** Whether the seller operates multiple locations. If, for example, the seller owns and operates the same type of business (including the one you are purchasing) at multiple
business locations and you are purchasing only one of the businesses owned by the seller, you must verify the integrity of the seller’s financial information and insure that the seller is not inflating the financial performance of the business that you are purchasing by allocating expenses or production costs to the business that you are not purchasing—thereby creating the appearance of increased profit margins at the business you are evaluating;

- **Government Regulation.** Whether or not the business is subject to government regulation and the likelihood of increased regulation or operation requirements that may adversely affect the financial performance of the business in the future. While this may be a difficult task to evaluate, a purchaser should start by reviewing and contacting local trade organizations and regulatory entities, if any, to check on the status of the industry and pending changes that may be on the horizon. For example, if the business you are considering relies on equipment that may have an affect on the environment—such as the equipment utilized by a gas station, dry cleaner or furniture manufacturer—you must determine the status of the seller’s equipment and if there are any pending regulations that will render this equipment obsolete or require modification;

- **Key Employees.** Whether or not the business relies on relationships between key employees and the businesses customers. If this is the case, your purchase agreement should contain a contingency based upon your employment of
these key employees and the possibility of obtaining non-compete agreements from these employees. Also consideration should be given to negotiating a “non-solicitation” clause whereby the seller represents and agrees not to employ or solicit the employment of your key employees.

Financial performance: additional due diligence factors to consider when the business is a franchise

- **Disclosures Contained in the Franchisors FDD.** When purchasing a franchise you will be afforded the benefit of additional disclosures contained in the franchisors FDD. If you are establishing a new franchised location (as opposed to buying an existing franchise) the franchisor must provide you with a current copy of the franchisors FDD which must be delivered to you no less than fourteen (14) days prior to your execution of the franchise agreement or the payment of any money to the franchisor. If you are purchasing an existing franchise the franchisor is not required to provide you with its FDD but, you should nevertheless make every effort to obtain a copy—ask the seller or even the franchisor.

  From a financial due diligence perspective the FDD contains information that should be evaluated and discussed with your franchise lawyer and accountant. Some of the relevant FDD sections that should be evaluated are summarized, as follows:
• **FDD Item “5”, “Initial Fees”**. This section of the FDD should include the disclosure of the initial “Franchise Fee” that you may be required to pay. Initial Franchise Fees are typically, one-time (non-refundable) fee paid by a franchisee upon executing the franchise agreement. If you are purchasing an existing franchise you should not be required to pay a franchise fee—however the franchisor may charge a “franchise agreement transfer fee”. From a purchasers perspective when buying an existing franchise always attempt to negotiate the franchisors “transfer fee” as an expense to be paid exclusively by the seller.

• **FDD Item “6”, “Other Fees”**. This section of the FDD should include a table summarizing other recurring fees and expenses that you should expect to incur. These fees must be carefully evaluated. Fees that you should not particular attention to and evaluate, include:

  - Royalty Fees;
  - National Advertising Fees;
  - Marketing Development Funds;
  - Local Advertising Expenses; and
  - Grand Opening Expenses.

• **FDD Item “7”, As discussed earlier, this section of the FDD contains the franchisors “estimate” of the expenses necessary to establish your franchised business. If you are purchasing an existing business, naturally the Item “7” estimates will be
of limited value to you. FDD Item “7” should include estimates for the following types of expenses:

- Initial Franchise Fee;
- Grand-Opening Marketing;
- Architectural Plans;
- Lease Deposits;
- Real Property;
- Leasehold Improvements;
- Furniture, Fixtures and Equipment;
- Signs;
- Initial Inventory;
- Business Licenses;
- Travel;
- Utility Deposits;
- Insurance; and
- Reserve Capital.

- **FDD Item “8” Restrictions on Sources of Products and Services.** In addition to the royalties and fees paid by franchisees, many franchisors generate revenues and profit from the sale of their proprietary products and supplies to franchisees. You must anticipate that your proprietary product purchases will constitute a significant percentage of your
on-going day-to-day operating expenses. As such the prices that you will be charged for “proprietary products” will directly impact your profits.

FDD Item “8” is intended to provide franchisees with information about your obligation to purchase “proprietary products” and how the franchisor may benefit from your purchases. You must evaluate this section thoroughly, speak to your franchise lawyer about your proprietary purchase obligations and discuss this information with existing franchisees.

- **FDD Item “19”, Financial Performance Representations.** If a franchisor wishes to make any representations about this financial performance of its franchises, the franchisor is required to disclose these representations in Item “19”. Before making a financial performance representation to you a franchisor must (a) possess a “reasonable basis” for the representation and (b) include the representation in Item “19” of the FDD.

  Caution: The majority of franchisors do not include financial performance representations in their FDD and even where representations are made they typically involve an analysis of “gross sales” and not the profitability of their franchisees. Never rely on financial performance representations unless they are expressly stated in the FDD and you have had an opportunity to review the representations with your accountant and franchise lawyer. Never rely on oral representations.
• **Royalty Fees.** As a franchisee, one of the most significant and recurring expenses that you will incur are the “royalty” fees that you will be required to pay to the franchisor. Royalties represent the ongoing fee that you must pay to the franchisor to continue the operations of your business. The royalty fees that you will be charged (once you become a franchisee) are typically fixed as a set percentage of your gross sales. Royalties are typically recurring and paid on a weekly or monthly basis. If, for example your franchise agreement requires the payment of a 5% royalty paid on a weekly basis then very week you will be required to pay the franchisor a royalty fee equal to five (5) percent of your overall gross sales. When calculating royalties keep in mind that you are typically dealing with gross sales and, as such, your “profitability” is of no concern to the franchisor.

• **Advertising Fund Fees.** The Advertising Fund Fees—typically a percentage of “gross” sales or a fixed fee—that must be paid by the seller (and eventually you once you purchase the business) on a weekly, monthly or annual basis.

• **Administrative Fees.** Reporting fees and additional administrative obligations. As a franchised business you will be required to report revenue and other income data to the franchisor on a weekly or monthly period. While most systems are, typically, automated, you can expect higher administrative costs (for accounting and bookkeeping services) than in a traditional non-franchised business;
• **Proprietary Products.** Proprietary product purchases for inventory and supplies that must be purchased from the franchisor or the franchisor’s approved suppliers only. As a franchisee the seller (and eventually you once you purchase the business) will, most likely, be restricted to purchase certain items of inventory, supplies and equipment from the franchisor or the franchisor’s approved suppliers. This obligation will exist in the franchise agreement that you are assuming and will be based on the franchisor’s right to control the quality and nature of the inventory, supplies and equipment that the “franchisor” believes or claims to be proprietary to the franchise system. This is an important factor to consider in your financial due diligence because, more likely than not, the franchisor and its approved suppliers will charge more for their “proprietary” products and supplies than other vendors may charge for goods that you believe to be identical or of similar quality. Keep in mind that what a franchisor considers to be “proprietary” could be quite extensive, ranging from napkins, to bacon, to specialized ovens and equipment.

• **Franchise Term.** For valuation purposes, you must consider the remaining term on the franchise agreement and the cost associated with renewing the franchise. Please keep in mind that there is no guarantee that the franchisor will renew or extend your rights as a franchisee. Accordingly, prior to purchasing the business, an agreement should be reached with the franchisor as to possibly extending the term of
your franchise. At a minimum the remaining franchise term should be equal to your remaining lease term.
The Nature of the Transaction: Asset Purchase Verses Stock Purchase

Once you have identified a business and have completed your due diligence, as a purchaser, you must discuss with your business attorney and business accountant the available methods for acquiring the “business”. The method by which a purchaser acquires an existing business or franchise is typically boiled down to one of two options, comprised of either (a) an “asset purchase”—where you purchase the seller’s business assets, or (b) a “stock purchase”—where you purchase the stock in the selling corporation.

The asset purchase transaction.

This business acquisition method is exactly what it says and refers to the purchase and acquisition of the seller’s business assets. In an asset purchase transaction, at closing, the tangible assets, property interests and good will of the seller are transferred to the purchaser. In this acquisition method a purchaser typically cuts off liabilities of the Seller and is free to choose what, if any, liabilities of the seller that the purchaser agrees to assume. After closing the seller is typically left with no assets and the purchaser will have acquired title and ownership to the business assets. For example, the seller’s property/store lease and tangible hard assets will be assigned and transferred to the purchaser. Likewise the seller’s goodwill assets will be
transferred to the purchaser by way of specialized agreements such as trademark assignments, confidentiality and non-competition agreements.

After closing, as a purchaser (in an asset purchase transaction), if everyone has done his or her job, you should be left with a new corporate entity that owns all of the seller’s business assets without the seller’s liabilities.

**The stock purchase transaction.**

This business acquisition method refers to a purchaser’s individual purchase of the stock (not the business assets) of the existing corporate entity of the seller. Under this method, you are not purchasing any business assets but rather purchasing stock in an existing company. Since the company will, presumably, already own the assets of the business, you will be indirectly acquiring these assets. At closing, the shareholders of the seller corporation (the entity that presumably owns the business assets) will simply deliver the physical stock certificates in the corporation to you and you will, individually, become the corporation’s new shareholder.

**Take caution when proceeding with a stock purchase**

When you proceed with a stock acquisition to purchase a business you will be taking over an existing corporate entity. Although this corporate entity will own the “business assets” this corporation (that, most likely, has been an existing legal entity long before this transaction) may have significant unpaid tax obligations and liabilities (i.e., employee contracts, unpaid vendor agreements and sales tax obligations) for which this company—and now you,
indirectly, as its new shareholder—will ultimately be accountable for. If these liabilities are not discovered and adequately addressed prior to closing, you could jeopardize your entire investment in the business. Additionally, a stock acquisition involves numerous additional considerations that will require consultation with both your business lawyer and accountant.

In almost all but a very few circumstances—circumstances that go beyond the scope of this book, from both a legal and accounting standpoint, the purchaser of a small to medium size business will be better served by proceeding with an “asset purchase” as opposed to a “stock purchase”. Proceeding by way of an asset purchase will serve to afford a purchaser with numerous legal and accounting benefits not available in stock purchase transactions.

**Advantages to a purchaser when proceeding with an “asset purchase” compared to a “stock purchase”**

- **Reduced Liability.** In the asset purchase transaction, the purchaser acquires the assets of the seller and may negotiate what, if any, liabilities of the seller that the purchaser may be willing to assume. If done properly, in most asset purchase transactions, all liabilities of the seller are cut off. This option is not available in a stock purchase transaction where the purchaser is buying stock in a corporation that may be subject to undiscovered liabilities and lawsuits.

- **Increased Tax Deductions.** In the asset purchase transaction, the purchaser is given the opportunity to fully value and “step up” the basis of the assets purchased. Basically, the
assets, including goodwill, will be valued on the purchaser’s books and records for amounts equal to the full amount of the purchase price and will therefore result in greater depreciation deductions that will benefit the purchaser down the road. In the stock purchase transaction, since you are purchasing stock—not the business assets—you inherit the existing financial statements of the seller that, in all likelihood will have seriously depreciated the assets of the business and have diminished the beneficial depreciation deductions that will be available in the future.
The “Asset Purchase Agreement” is the primary vehicle and agreement by which the vast majority of all businesses are purchased and sold. After having discussed the benefits of an “asset purchase” compared to a “stock purchase”, it is important for a prospective purchaser to possess an understanding of the “Asset Purchase Agreement” and the typical issues and legal clauses addressed in this agreement.

Identification of the seller and the seller’s individual shareholders.

At the most basic level the asset purchase agreement will identify the seller who, as discussed, will typically be a corporate entity owned and controlled by one or two shareholders. Although the seller is a corporate entity, it is critical for the seller’s individual shareholders to be identified in and be a party to the purchase agreement. Why? Because the asset purchase agreement includes important representations and post-closing obligations and covenants (such as confidentiality, non-competition and non-solicitation covenants) that must remain enforceable against the seller’s individual shareholders after you purchase and acquire the business. After the
closing, the seller, a corporate entity, will, basically, be an empty shell with little or no assets.

**Identification of the purchaser.**

As discussed earlier, once your due diligence is complete and you have elected to proceed with the business transaction, after consultation by and between your business attorney and business accountant, your attorney will establish a corporate entity (typically a corporation or limited liability company) that will constitute the legal entity that will be purchasing the assets of the business. You will be the shareholder or member of this new corporate entity. If the purchase transaction involves both the purchase of business assets and the purchase of real property, typically, you will be advised to establish two distinct corporate entities, one to acquire and own the business assets and one to acquire and own the real property.

Under the following circumstances it may be more beneficial for a purchaser to sign the asset purchase agreement “individually” (i.e., not as a corporate entity) provided that you, as the purchaser, are granted the express right to later assign the agreement to a corporate entity just prior to closing:

- Where the time period between contract signing and closing will be a number of months and holding off on establishing the purchaser’s corporate entity will avoid unnecessary year end accounting fees and taxes charged to this mostly inactive entity;

- Where the asset purchase agreement is subject to various contingencies (such as a due diligence or financing
contingency) that may result in the eventual termination of the purchase agreement; and

- Where the nature of the transaction has progressed in a manner where the purchaser has not had a full opportunity to evaluate the appropriate corporate entity to establish.

Under the foregoing circumstances (where you are identified as the individual purchaser) the asset purchase agreement must include an absolute right for the purchaser to transfer and assign the agreement to a corporate entity prior to closing.

The purchase price.

The agreement will, naturally, state the price that you have agreed to pay for the assets of the business. Although the purchase price is self explanatory, it is critical for the asset purchase agreement to expressly state how, for taxation and financial reporting purposes, the purchase price will be allocated among the various components of the business assets being purchased. Typically, the asset purchase agreement should specify and allocate the purchase price among the following classes of assets:

- Furniture, Fixtures and Equipment (Tangible Assets);
- Leasehold Improvements;
- Goodwill;
- Covenant not to compete;
- Inventory.
The decision as to the appropriate purchase price allocation is one that should be made between both your business attorney and business accountant. The allocation of the purchase price will have both upfront tax consequences (such as the purchaser’s obligation to pay possible sales tax on the portion of the price allocated to the tangible assets) and long term consequences in terms of the applicable depreciation and amortization periods that will be afforded to the different classes of assets that you will be purchasing. For example, although allocation of the purchase price to tangible assets may create an upfront sales tax liability for a purchaser, the tangible assets are more quickly depreciated (affording quicker tax deductions) than intangible assets such as goodwill that is depreciated over a much longer period of time.

At the outset, it is also important that you determine and clearly negotiate whether or not inventory is included in the purchase price or if inventory (if applicable at all) will be a closing adjustment added to the purchase price that will be due to the seller at closing.

**The contract deposit.**

The contract deposit is the deposit that will be paid by you to the seller’s attorney upon signing the purchase agreement. The contract deposit, also known as a “good faith deposit” is designed to commit you to the purchase transaction and to demonstrate your good faith intention in proceeding with the transaction and acquiring the seller’s business. If you breach the purchase agreement (i.e., later decide you do not want the business) then your contract deposit could be in jeopardy and retained by the seller as damages. It is critical that a contract deposit be paid only after the terms of
the purchase agreement are finalized and be issued “only” to the seller’s attorney, as an escrow agent, and be maintained in an insured attorney trust account. A purchaser should never advance a contract deposit unless the deposit is coordinated with and approved by your business attorney.

Identification of the assets.

In earlier sections in this book I discussed the various assets of a business. It is critical that your asset purchase agreement list, in detail, each and every asset that you believe you are purchasing. Although the tangible assets should be easy to identify (i.e., simply list each item of equipment, furniture and fixtures), detail and thought should be given to adequately identify and list intangible or “goodwill” related assets, such as: (i) telephone numbers, (ii) internet domain name addresses, (iii) trade names and trademarks, (iv) existing websites, (v) copyrighted materials contained on the website and other publications utilized by the seller, and (vi) customer lists and customer purchase information.

Financing of the purchase price.

In the typical business purchase transaction a portion of the purchase price may be obtained through a loan. Generally, there are two forms of business financing, comprised of:

- **Seller “Purchase Money” Financing.** This form of financing is provided by the seller (depending on your negotiations and the circumstances) and amounts, essentially, to the seller’s agreement to defer payment of a portion of the purchase price. At closing, the portion of the purchase price
“financed” by the seller will be represented by a promissory note that will constitute your legal obligation to repay the loan to the seller and will identify the particulars of your loan, including, the total amount of the loan, the interest rate charged and the repayment terms and dates.

Seller financing is typically a beneficial financing vehicle for a purchaser since it is more readily available than a loan from a financial institution and is less expensive in terms of closing costs and fees. Seller financing and its availability also provides a purchaser with some indication as to the seller’s commitment to the transaction and the seller’s belief as to the fairness of the purchase price. For example, if the seller believes that the price is not fair or that the business does not generate sufficient cash flow to allow you to repay the loan that will be due to the seller after closing, then the seller may be less inclined to offer purchase money financing.

• **Third-Party Lender Financing.** Is financing provided by a third party lending institution. There are many forms of lender financing ranging from loans from commercial banks to government insured and sponsored loans through the United States Small Business Administration. In most instances the administrative expenses and fees associated with lender financing (including the Small Business Administration) are substantial and must be factored into the financial viability of the purchase transaction.

If you intend to also rely on financing from the seller (“purchase money financing”), then this form of financing
must be expressly acknowledged in the purchase agreement. The purchase agreement should include a form of the promissory note that you will be required to sign at closing and must state the specifics of the loan including, the amount of the loan, the interest rate and the repayment terms. If your purchase transaction depends on obtaining a loan from a third party lender (such as a bank or the Small Business Administration) then your purchase agreement must include a “financing contingency clause.” The mortgage contingency clause will protect your down payment by conditioning the purchase agreement on your ability to obtain a particular loan. If you cannot obtain the loan—provided that you comply with the terms of the financing contingency—then, as a purchaser, you will be permitted to terminate the purchase agreement and receive a refund of your contract deposit.

**Agreement contingencies.**

At the time of signing the purchase agreement you will, most likely, be advancing a significant sum of money in the form of a contract deposit and you will be committing yourself to purchasing the seller’s business. However, since, in most instances, not all issues are resolved at the time of contract signing, it is critical for you to identify with your business attorney “contingencies” and events that would permit you to cancel the purchase agreement and recover your contract deposit. These contingencies must be evaluated prior to signing the purchase agreement and must be negotiated with the seller and included in the purchase agreement. The possible contingencies that should be considered in a purchase agreement vary
widely depending on the nature of the business, the purchase price and the negotiations between the parties. Some of the many contingencies that a purchaser may consider, include:

- **Due Diligence Contingency.** As indicated earlier, this contingency permits a purchaser to sign the purchase agreement and advance a contract deposit prior to completing due diligence. If the purchaser follows the terms of this contingency clause (however such terms are drafted and included in the purchase agreement) then a purchaser, upon timely notice to the seller, may cancel the purchase agreement and receive a refund of the contract deposit. In the earlier “Due Diligence” chapter of this book, I included the text of the due diligence contingency clause that I typically negotiate on behalf of my clients;

- **Financing Contingency.** If your ability to purchase the business and pay the purchase price is dependent on a loan from a third party lender, then the purchase agreement must include a “financing contingency clause” stating that the purchase agreement is contingent on your receipt and approval of a particular loan. This clause must be specific and include, among other things, the time period you will be given to obtain a loan commitment, the maximum amount of the loan and the source of the loan, *i.e.*, will the loan be from a financial lender or a government insured program such as those offered by the Small Business Administration. Likewise, if the transaction is conditioned upon financing
from the seller, this must be specified in the purchase agreement;

- **Lease Assignment Contingency.** Since a business is of no value without the underlying lease (unless you are purchasing the property), the purchase agreement must specify that the entire transaction is contingent upon the landlord’s approved assignment of the seller’s lease agreement to the purchaser. If you require an extension of the lease term or some other modification to the seller’s existing lease then these modified terms “must” be included as part of the lease contingency;

- **Franchise Assignment Contingency.** When purchasing an existing franchise you must obtain the written consent of the franchisor. The purchase agreement must specify that the entire transaction is contingent upon the franchisor’s approved assignment of the seller’s existing franchise agreement. If you require an extension of the franchise agreement or a modification of its terms then these modified terms “must” be included as part of the franchise agreement contingency;

- **Licensing Contingency.** If the business that you are purchasing requires a specialized license to continue the operations of the business (*i.e.*, such as a liquor license for a restaurant or a license from the banking department to operate a check cashing establishment) then the purchase agreement must include a contingency based upon your ability
to obtain the applicable license or the approved transfer of the sellers license; and

- **Other Contingencies.** Keep in mind that every business and business transaction is unique and, depending on the circumstances and negotiations, your business attorney should consider the inclusion of all reasonable contract contingencies that may or may not be required for you to proceed with the purchase agreement.

**Closing information.**

“Closing” refers to the date and process by which the purchase agreement is completed. At the time of closing, the seller will legally transfer the business assets to you and you will, essentially, pay the purchase price. While a lot more will be involved, it is nevertheless important to understand what the term “closing” refers to.

Please keep in mind that the foregoing summary of the asset purchase agreement is, just that, a summary and is designed to make you aware of the flexibility of the purchase agreement and your ability, as a purchaser, to work with your business attorney to negotiate and formalize an agreement that will significantly influence the transaction and the level of risk that you may or may not be exposed to.
Mistake No. 1: Failure to obtain written landlord consent to the lease transfer and the landlord’s acknowledgment as to the enforceability of the lease

The majority of business transactions involve the seller’s transfer and assignment of the lease for the business location. Procedurally, the transfer of a seller’s lease is achieved by a one page (or even one paragraph) document known as a “lease assignment.” In the lease assignment the seller (who is the tenant under the lease) assigns his or her rights in the lease to you—the purchaser of the business and soon to be new tenant. While all leases are different and should be examined in detail, in almost all commercial transactions, a seller’s ability to assign his or her lease to a prospective business purchaser will be restricted and require some form of approval or acknowledgment by the landlord. In many instances (especially with small businesses) the seller’s lease agreement may not be clear and an ambiguity may exist as to the seller’s ability to assign the lease
and the type of consent that may or may not be required from the landlord.

When a landlord is presented with a requested lease assignment, in many instances, the landlord may view the potential assignment as a revenue generating opportunity and refuse to consent to the assignment unless he or she is paid a lease assignment fee from either the seller or purchaser. Since the landlord may possess relevant concerns respecting the proposed assignment (such as the creditworthiness of the new purchaser/tenant), in most business transactions, obtaining the landlord’s consent will prove to be a time consuming and difficult process that may jeopardize the entire business transaction.

Due to the difficulty in obtaining the landlord’s written consent, in many instances—especially where the seller is faced with a time constraint and needs to sell the business right away—the business seller may attempt to avoid or circumvent the approval process and convince you (the purchaser) to proceed with the business closing without the required approval or acknowledgment from the landlord. To do this, typically the seller will advance one of the following arguments as to why consent is not required:

1. **Seller’s Position:** The landlord will never find out about the sale.

   **Reality:** The landlord always finds out and even if this were somehow true, why would you invest your livelihood and time in a business that could immediately lose its lease;
2. **Seller’s Position:** The original lease agreement states or somehow authorizes the seller to assign the lease without the landlord’s consent.

**Reality:** While this may be true (and you should only assume so if your attorney confirms this), you will still need the landlord’s written acknowledgment to confirm that the lease being assigned to you is current with no outstanding defaults by the seller and no outstanding or past due rent.

3. **Seller’s Position:** That although the lease prohibits an “assignment” (i.e., from the Seller’s corporation to you the purchaser), nothing in the lease prohibits the seller from transferring the “stock” in the seller corporation to you as the purchaser. The seller’s reasoning (and argument to persuade you to close without the landlord’s consent) is that you will now be the owner of the seller corporation that remains the tenant under the lease.

**Reality:** This is a known and typical “end-run” around lease assignment prohibitions in commercial lease agreements. As such, most commercial lease agreements will prohibit a seller/tenant’s transfer or sale of stock to a third party without the landlord’s consent. Accordingly, in many instances, the stock sale will be viewed as an unapproved lease transfer and the lease will be automatically violated. Even if this prohibition (i.e., the transfer of the seller’s stock) is not contained in the lease, you will still
require the landlord's written acknowledgement as to the enforceability of the lease.

How experienced entrepreneur’s avoid mistake no. 1:

Always insist on obtaining the landlord’s written consent to the assignment of the business lease and an acknowledgment as to the enforceability of the lease. The landlord’s consent must: (a) be in writing; (b) be signed by the landlord; (c) acknowledge the landlord’s approval of the assignment; (d) expressly acknowledge that the lease is in “full force and effect” with no outstanding defaults by the seller; and (e) acknowledge the amount of the tenant’s security deposit.

Mistake No. 2: Failure to obtain a post-closing “non-competition” covenant from the seller “and” the seller’s individual shareholders

Critical to every successful business has been and remains the goodwill and personal relationship that each business owner possesses with his or her customers. The valuable nature of this relationship is typically acknowledged and (somewhat) protected in the majority of business purchase agreements through the inclusion of a “non-competition” covenant, i.e., a paragraph in the purchase agreement where the seller agrees not to compete with the purchaser within a specified territory for a specified period of time.

The problem with some “non-competition” covenants used in business purchase agreements is that the language/covenant incorporated into the agreement fails to “personally” obligate and bind
the individual shareholders of the selling corporation, *i.e.*, in far too many small business transactions the language used in the “non-competition” covenant applies only to the “seller” and fails to recognize that the “seller” is a corporation (and basically a shell entity that will possess no assets after closing) and does not obligate or restrict the activities of the seller’s individual shareholders who possess the true relationships with the customers of the business. In addition to the individual shareholders of the selling corporation, depending on the circumstances, as a purchaser you must also evaluate and consider whether or not the spouse(s) of the individual shareholders possess a threat to your new business and whether or not you should demand that their activity also be restricted.

**How experienced entrepreneur’s avoid mistake no. 2:**

Always insist that: (a) the business purchase agreement include a detailed and specific “non-competition” covenant; (b) that the “non-competition” covenant survive closing; (c) that the “non-competition” covenant name the seller and the individual shareholders of the seller; (d) that the business purchase agreement and the “non-competition” covenant be signed by both the seller corporation and the individual shareholders in their “individual capacity”; and (e) give serious consideration to demanding that the spouse(s) of the seller’s shareholders be named and obligated to the “non-competition” covenant.
Mistake No. 3: Failure to obtain a post-closing “non-solicitation” covenant

While non-competition covenants and agreements (discussed in Mistake No. 2) are common, in far too many small business transactions, the typical purchaser and his or her legal counsel neglect the importance of including a “non-solicitation” clause in the business purchase agreement. If drafted properly, the “non-solicitation” clause will provide supplemental protection to the “non-competition” covenant by prohibiting the seller (and, if prepared properly, the seller’s individual shareholders) from “soliciting” the employment of your key employees or the business of your customers for the benefit of a third-party competitor. Keep in mind that, in all likelihood, the seller will be well acquainted with many of your employees, customers and competitors and the last thing that you will want to happen to your business is to have the seller (and now the former owner of your business) contacting employees or customers on behalf of a competitor or anyone else. Absent a “non-solicitation” covenant, as a business purchaser, you will be exposed to the possible wrongful acts of the seller that may not necessarily be prohibited by the standard “non-competition” covenant found in most business agreements.

How experienced entrepreneur’s avoid mistake no. 3:

Always insist that: (a) the business purchase agreement include a detailed and specific “non-solicitation” covenant; (b) that the “non-solicitation” covenant specifically and clearly prohibit the seller from soliciting the business of your customers or the
employment of your employees for the benefit of a competitor or anyone else; (c) that the “non-solicitation” covenant survive closing; (d) that the “non-solicitation” covenant name the seller and the individual shareholders or members of the seller; (e) that the business purchase agreement and the “non-solicitation” covenant be signed by both the seller corporation and the individual shareholders in their “individual capacity”; and (f) give serious consideration to demanding that the spouse(s) of the seller’s shareholders be named and obligated to the “non-solicitation” covenant.

Mistake No. 4: Failure to negotiate and specify the rent for a lease renewal term

When purchasing a business, in most instances, one of the assets that you will be acquiring will be the seller’s interests (as a tenant) in the underlying lease agreement for the business premises. In all likelihood, the lease will have been in existence for a number of years and, as a purchaser, you will require or demand an extension of the lease term (i.e., if the lease has only five years left, you may negotiate as a condition for purchasing the business that the landlord agree to extend the lease term for an additional five years). While many landlords are typically reluctant to agree to a lease renewal or extension prior to the expiration of the original lease term (typically because the landlord will possess greater negotiating leverage when the lease is closer to its expiration date), in many instances the landlord may offer the new business purchaser an additional lease renewal term but will do so without committing to the specific amount of the rent that will be charged during the renewal period,
i.e., the lease will state that rent during the renewal term will be increased over the prior years rent by an amount that shall reflect the then current “market rates” (for rent) in effect at the time of the renewal period. Since rent is a key factor to all lease agreements, any renewal term or extension based upon a future determination of “market rent” is, in all likelihood, illusory and of little business value. You will be left with little certainty as to your future rent and you will be almost guaranteed a future dispute with your landlord as to how your renewal term rent will be calculated and determined.

**How experienced entrepreneur’s avoid mistake no. 4:**

Always insist that the lease to be assigned to you as a purchaser: (a) possesses a sufficient remaining term (number of years left) that will enable you to successfully recover your investment in the business; and (b) insist that any negotiated renewal term with the landlord specify the rent and not rely on any future agreement or “market” determination.

**Mistake No. 5: Failure to file the mandatory pre-closing bulk sales tax notification**

(New York) For business transactions occurring in the State of New York, the New York State Department of Taxation and Finance imposes a liability and obligation on the business “purchaser” to provide the State with a “pre-closing” notification of the proposed business sale, the terms of the sale and the anticipated date of closing. This pre-closing notification is typically referred to as a “Bulk Sales Notice” it should be prepared by your business attorney
and *must* be filed with the New York State Department of Taxation and Finance *no less than 10 days prior* to the business closing. The purpose of this notification is to assist the State with its sales tax audit and collection efforts, *i.e.*, when the taxation authority receives the notification, the State will examine the “seller’s” tax records and make a determination as to whether or not the “seller’s” tax records are current and whether or not the “seller” owes any outstanding sales tax. If outstanding sales taxes are due by the “seller”, the State of New York imposes an obligation on the business “purchaser” to pay the “seller’s” outstanding sales tax from the business purchase proceeds due from the purchaser to the seller at closing. If the business purchaser does not satisfy the “seller’s” outstanding sales tax (from the proceeds due to the seller at closing) the State of New York will hold the “purchaser” personally liable for the seller’s outstanding taxes.

Procedurally, the bulk sales notice must be timely pre-filed with the New York State Department of Taxation and Finance. Once this notice is timely pre-filed, you must discuss and review with your attorney the State’s response and whether or not a closing may occur before a final determination by the State of New York. It is critical to note that the bulk sales notice is time sensitive and, if taxes are due, the State of New York has up to 90 days (from the date of receipt of the bulk sales notice) to advise you as to the exact amount of sale tax due from the seller and to be collected at closing. If you intend to close prior to this 90 day notification period, you must discuss your notification, escrow and sales tax collection obligations with your business attorney.

If you fail to comply with the New York State bulk sale notification and collection obligations, the State of New York can and will
hold you personally responsible for the payment of the seller’s outstanding pre-closing sales taxes. This obligation may be substantial and is an unnecessary problem that occurs in far too many transactions. While this issue must be addressed by your business attorney, it is important that, as a business purchaser, you be aware of this “hidden” liability.

**How experienced entrepreneur’s avoid mistake no. 5:**

Always insure that: (a) you have discussed and reviewed this issue with your business attorney and accountant; (b) your attorney has timely filed (at least 10 days prior to the date of closing) the bulk sales notice; (c) your attorney has received a response from the State as to the existence or non-existence of any outstanding tax liability due by the seller; and (d) if a closing occurs prior to a final determination by the State, that you have reviewed your escrow obligations with your attorney and that the proper amount of the proceeds due to the seller at closing are set aside and held in escrow on behalf of the State.

**Mistake No. 5A: Failure to file the mandatory pre-closing bulk sales tax notification**

(New Jersey) For business transactions occurring in the State of New Jersey, the New Jersey State Division of Taxation imposes an absolute liability and obligation on the New Jersey business “purchaser” to provide the State with a “pre-closing” notification of the proposed business sale, the terms of the sale and the anticipated date of closing. This pre-closing notification, referred to as a “Bulk Sales Notice” (but formally identified by the State as a “Notification of Sale,
Transfer or Assignment in Bulk”) should be prepared by your business attorney and must be filed with the New Jersey State Division of Taxation no less than 10 days prior to the business closing. The purpose of this notification is to assist the State with their sales tax audit and collection efforts, i.e., when the taxation authority receives the notification, the State will examine the “seller’s” tax records and make a determination as to whether or not the “seller’s” tax records are current and whether or not the “seller” owes any outstanding sales tax. If outstanding sales taxes are due by the “seller”, the State of New Jersey imposes a liability and obligation on the business “purchaser” to pay the “seller’s” outstanding sales tax from the business purchase proceeds due from the purchaser to the seller at closing.

Procedurally, the bulk sales notice must be timely pre-filed with the New Jersey Division of Taxation. Once this notice is timely pre-filed, the State will review the Seller’s tax records and make a determination as to an amount due or an amount to be set aside and held in escrow at closing. Provided that you have timely notified the State and have set aside the appropriate escrow of funds demanded by the State, you may proceed with the closing without any further liability for the seller’s sales taxes.

If you fail to comply with the New Jersey State bulk sale notification and collection obligations, the State of New Jersey can and will hold you personally responsible for the payment of the seller’s outstanding pre-closing sales taxes. This obligation may be substantial and is an unnecessary problem that occurs in far too many transactions. While this issue must be addressed by your business attorney, it is important that, as a business purchaser, you be aware of this “hidden” liability.
How experienced entrepreneur’s avoid mistake no. 5:

Always insure that: (a) you have discussed and reviewed this issue with your business attorney and accountant; (b) that your attorney has timely filed (at least 10 days prior to the date of closing) the bulk sales notice; (c) that your attorney has received a response from the State as to the existence or non-existence of any outstanding tax liability due by the seller; and (d) at closing, all escrows demanded by the State are properly set aside and withheld from the purchase price proceeds due to the seller.
As the prospective purchaser of a business or franchise—whether you are a first time purchaser or a veteran entrepreneur—you are about to engage in a process that will require you to make decisions that have long-standing implications. As a business attorney I have had the honest pleasure of witnessing the tremendous success and growth experienced by those clients that have understood the purchase transaction, the business that they were purchasing, paid a fair price and committed to hard work and long hours after the business closing. However, not every business transaction is profitable and, in too many instances, a purchaser will become involved in a business transaction without possessing the necessary tools to effectively understand and participate in the transaction. In this book, I hope that I have provided you with a tool (one of many that will be needed) enabling you to better understand the transaction, better utilize the counseling and advice of your business lawyer and accountant, better understand information presented to you by the seller or the seller’s brokerage professionals and, most significantly, to better increase the odds that the business you are considering is the right one for you.

If you have a question about this book, the legal services offered by my law firm, a comment as to your experiences with this book or suggestions for future editions, I welcome your input either
by email at cinternicola@dddilaw.com or by phone at 1-800-976-4904.

The following articles address specific issues and factors that should be considered in certain business and franchise transactions. The following is an index of the articles included in this supplement:

- What is the Right Price when Buying a Business or Franchise?

- Why your “Investment” in a Franchise will Involve Much More than Franchise Fees and Start-Up Expenses?

- Why it is Important to Contact Existing Franchisees before Signing a Franchise Agreement and How to Identify Franchisees to Contact?

- Three Initial Questions that you Should Ask Existing Franchisees before Buying a Franchise?

- Should You Buy a Business or Franchise to Replace a Lost job?
What is the Right Price When Buying a Business or Franchise

This is a frequent question that naturally comes up when representing my clients in business and franchise purchase transactions. Although “lawyers” are not qualified to answer this question, nevertheless, I believe that issues involving due diligence and valuation must be discussed with your business attorney prior to signing any agreement. The following are some important factors that a prospective business purchaser or franchisee should be considering:

- **Due Diligence is Critical** – always insure that you thoroughly review the finances (tax returns, royalty reports, purchase order receipts and register receipts) of the business that you are purchasing to verify the earning claims of the seller.

- **Conduct on Site Due Diligence** – Don’t stop at a “paper review”, spend time “on-site” interacting with customers and sampling/measuring daily sales. This is not asking too much and the attorneys can structure confidentiality agreements to protect the seller and encourage him or her to provide you with access.
• **Include a Due Diligence Contingency Clause** – If your financial review/due diligence cannot be completed prior to signing the business purchase or franchise agreement, then ensure that your agreement includes a “due diligence contingency clause” enabling you to complete your review and back out of the agreement if necessary.

• **Coordinate Communications** – Ensure that your attorney, accountant/valuation professional speak and coordinate their activities.

• **Remember that Profits (not Gross Sales) are Key** – This is an obvious point but one that should be emphasized again and again. The most important factor to you will be how much money you get to take home to your family on a weekly or monthly basis and not the gross sales of your business and how much you paid the franchisor in royalties. So don’t get enamored with gross sales, pay attention to the recurring expenses of the business.

Essentially, leave no stone unturned.
Why Your “Investment” in a Franchise Will Involve Much More Than Franchise Fees and Start-Up Expenses?

If you are considering the purchase of a franchise it is critical to recognize that your “investment” will go beyond the initial franchise fees and start-up expenses that you will incur. While franchise fees and start-up expenses (such as equipment purchases and “build-out”) are critical expenses that must be evaluated, they only tell half the story. That is, when signing a franchise agreement you will be committing yourself to a series of legal obligations that will involve the commitment of your time, future financial resources and legal obligations for many years to come.

So when evaluating the “cost” of a franchise, in addition to franchise fees and initial start-up costs, give some serious consideration to:

- **Reserve Capital.** Additional funds that you may be required to invest in your business/franchise during periods of unprofitability and negative cash flow. As with any business you may very well encounter periods of unprofitability and losses. When faced with losses and cash flow shortages you will be required to invest additional assets and resources to sustain the operations of your franchise;
• **Your Time.** The extensive time that your will be devoting to operating and managing your new franchise. Your time is valuable and when operating your franchise you will be foregoing income and opportunities from other sources of employment. Although obvious, this expense/opportunity cost is commonly overlooked. If your franchised business does not work out remember that your losses include missed opportunity costs and income that you would have otherwise earned.

• **Post-Termination Restrictive Covenants and Fees.** As a franchisee in most instances you will be committing yourself to long-term obligations and restrictive covenants. These covenants and obligations have a cost, especially when they restrict what you can and cannot do if you elect to shut down your franchise. This is of special concern to current business owners with established reputations within a community who—for legitimate reasons—decide to become a franchisee of a national company.

  For Example, if you are a carpenter with a long established reputation within a community and you elect to purchase and become a franchisee of a national “repair” or “handyman” franchise what happens if your franchise relationship does not work out and you cancel your franchise agreement? Will you be precluded from operating your own repair business—a business that you operated many years before becoming a franchisee? The answer is that it all depends on the restrictive covenants contained in your franchise agreement—covenants and obligations that you
should review and discuss in detail with your franchise lawyer “before” signing a franchise agreement.

So, when considering the “cost” of your franchise investment you must go beyond “out of pocket” expenses and fees and evaluate the substantive impact of the long-term legal obligations that you will be committing to.
Why It Is Important To Contact Existing Franchisees Before Signing a Franchise Agreement and How To Identify Franchisees To Contact

You have identified a franchise concept that you are extremely interested in. You have met with the franchisor's sales staff, completed an application and are impressed, so far, by what you see. However, before taking that next step, before paying a franchise fee or signing a franchise agreement, contact existing franchisees to get the “inside track”.

Where do you get existing franchisee information? In the franchise disclosure document (also known as the “FDD” and formally known as a Uniform Franchise Offering Circular) that must be provided to you by the franchisor at least 14 calendar days prior to you signing a franchise agreement or paying any fee to the franchisor. The FDD is an extensive document and, quite frankly, one of the few “life-lines” that will be available to help you make a true assessment of the franchise opportunity that you are considering. The legally mandated information contained in the FDD, and thereby disclosed to you as a prospective franchisee, is extensive, extremely relevant and should be reviewed with both a franchise lawyer and business accountant. However, sticking to the point of
this article, that is obtaining information from existing franchisees, please know the following:

- Item “20” titled “Outlets and Franchisee Information” should contain extensive information about (a) existing franchisees—including their names, addresses and contact information, (b) the number of franchise outlets in operation (at least as of the date of the FDD), (c) the number of franchise outlets that are expected to open within the next fiscal year, and (d) the number of franchise outlets that were closed, sold or terminated in the last fiscal year;

- Contact existing franchisees (not just the “star”—multi-unit franchisees who the franchisor suggests you speak with) and politely ask them about their experiences as a franchisee, the support given to them, the quality of the product (or service) and, if possible, the cash flow and profitability of the business;

- Pay particular attention to the number of franchise outlets closed, terminated or sold during the past year. If there are a significant number (relative to total overall outlets) of closed, terminated and/or sold outlets, proceed with caution and ask lots of questions. Please keep in mind that while it may be inevitable to have a few closed outlets due to a “franchisee’s mismanagement or lack of effort”, look out for a pattern of closings, terminations and outlet sales and do not just accept an explanation blaming a closed outlet on a franchisee’s lack of effort. In many cases, a closed outlet may be a function of neglect by both the franchisor (in
terms of support and product development) and the franchisee; and

- If the franchisor is projecting a significant increase in the number of projected outlet openings (a projection that should be included in Section 20 of the FDD) question whether or not the franchisor possesses the managerial staff and infrastructure to properly support all of these new outlets.

When purchasing a franchise, there is a lot to consider and, inevitably—like every entrepreneur, you are bound to make mistakes. However, by contacting existing (and terminated) franchisees you can learn from some of their mistakes and cut down on your own.
3 Initial Questions That You Should Ask Existing Franchisees Before Buying a Franchise

The purchase of a franchise represents a substantial investment that will have longstanding implications for both you and your family. Prior to selecting a franchise and deciding to move forward, you must engage in an active “due diligence” evaluation of the franchise system and determine if it is right for you. As previously discussed, existing franchisees are excellent sources of information when evaluating a potential franchise investment.

Three “initial” questions that you should consider asking existing franchisees, include:

- **Were you Satisfied with the Franchisor’s “Pre-Opening” Training and Support?** One of the advantages of purchasing a franchise, in theory, should be the support and training provided by the franchisor. The training and support that you receive prior to opening your franchise will be critical to launching a successful franchise. If current franchisees are not satisfied with the pre-opening training and support provided by the franchisor, seriously question whether this is the right franchise for you and speak to your franchisor lawyer about adding specific training guaran-
tees to your franchise agreement should you decide to go forward.

- **Are you Satisfied with the Franchisor’s “On-Going” Training and Support?** While many franchisees open their business to a successful launch and impressive sales, on-going support is crucial. A good franchise system is characterized by constant communication and support between the franchisor and its franchisees. If current franchisees are not satisfied with the on-going support offered to them, again, you must question whether or not this is the right franchise for you. Certainly raise this issue with the franchisor’s sales people and your lawyer.

- **Do the Numbers Make Sense?** In other words, after paying royalties, advertising fees, product costs and operating expenses does the business earn a profit? This is an apparent and critical question that too many prospective franchisees fail to consider and evaluate. When focusing on this issue ask as many questions as possible and speak to as many franchisees as you can. Gather information and then discuss this issue with both your business accountant and franchise lawyer.

In addition to these initial questions, you should have many others focused on the particular franchise that you are considering. I suggest that you write down a list of your expectations and then—prior to signing any franchise agreement—seek out and obtain as much information as possible to determine whether or not the
franchise that you are considering is right for you. Your decision should also be based on a candid discussion with your franchise lawyer and a thorough evaluation of the franchisor’s disclosure documents.
Should You Buy A Business or Franchise To Replace A Lost Job?

With the reality of unemployment and underemployment rates at historically high and, quite frankly, inexcusable levels, “interest” in entrepreneurship is growing. Many hard working and educated individuals are asking the question: “should I replace my lost job with my own business or franchise”. This is a critical question and is not easily answered.

So, should purchasing a business be viewed as a solution to a layoff? Unfortunately, the answer to this question is both “yes” and “no”. “Yes” because small business and entrepreneurship, unequivocally, has been and will continue to serve as the financial life-blood for millions of hard working individuals and families. “No” because entrepreneurship and small business is not right for everyone and unemployment, by itself, should not be the deciding factor. Not every small business is profitable and before you commit to buying a business or franchise, consider some the following questions:

- Do you possess sufficient savings, capital and/or loans necessary to:
  
  (a) purchase the business;
(b) fund the initial day-to-day operations of the business – keep in mind that it may take a number of months before your business generates “profits”; and

(c) cover your “personal” expenses and obligations until the business starts generating “profits”.

- Do you have the support of your Spouse and Family – as the owner of a small business you will be assuming a level of risk and commitment extremely different from that of an “employee”. Your investment in a business will affect the financial stability of your family for many years to come.

- Are you ready to “wear many different hats” – as the owner of a small business, different from being a specialized employee of a large corporation, you will be responsible for everything.

Although, many times, entrepreneurship may be the right course of action and response to a layoff, your decision to take this step must be based on factors that go beyond your employment status and include an evaluation of your financial resources, family support and individual skills.
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An Entrepreneurs Guide to Purchasing a BUSINESS or FRANCHISE

CHARLES N. INTERNICOLA is a leading business and franchise attorney with a legal practice dedicated to protecting the interests of individuals (including first time business purchasers) and non-public corporations in local, regional and national transactions. Mr. Internicola's franchise practice is national in scope and involves the representation of franchisees (considering the purchase of a franchise) and franchisors (establishing a franchise system) throughout the United States. For more information about Mr. Internicola and the services offered by his law firm, visit www.BusinessandFranchiseLaw.com or call 800-976-4904.

SOME OF THE IMPORTANT INFORMATION INCLUDED IN THIS BOOK
+ The 5 myths that must be ignored when purchasing a business;
+ Special factors and information unique and important to “franchisees”;
+ How to identify and evaluate the "assets" of a business;
+ "Due diligence" and the critical factors for evaluating a business;
+ Important factors for evaluating a lease; and
+ How to protect yourself after the business closing.

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A Practical No Nonsense Guide to Educate, Inform and Empower Business Purchasers and Prospective Franchisees