

Succession: The Legal Issues



HOFFER ADLER LLP
BARRISTERS & SOLICITORS • TRADE-MARK AGENTS

Succession Scenarios

- ❑ Death
- ❑ Permanent disability
- ❑ Retirement - Sale of franchise to a non-arms' length party (i.e., spouse, child or other relative)
- ❑ Divorce (Rarely identified as a cause for termination)

Context is Everything

- ❑ Difficult, trauma-laden scenarios
- ❑ Interrelationship between FA with a shareholders' (or partnership) agreement, wills and powers of attorney and family law considerations
- ❑ Consider your Zees' (survivors') perspective
 - Suffered a personal loss - emotional
 - Tax minimization and deferral
 - Reduce probate fees, in the case of death
 - Recover equity
 - Ensure that a successor is chosen

Franchisor's Objectives

- ❑ To ensure smooth transition
- ❑ To ensure that the brand is not detrimentally impacted during transition
- ❑ To continue to collect payments from franchise in question
- ❑ To accommodate grieving franchisee
- ❑ To terminate non-producing franchise

Triggering Events

- Death or permanent disability of:
 - Controlling shareholder
 - Any minority shareholder?
 - Manager/Key Person?

- Sale of shares to existing shareholders may be subject to a shareholders agreement, but terms of franchise agreement should prevail

Definition of permanent disability

- If usual and active participation in the franchise as contemplated by the franchise agreement is curtailed for a designated period of time
 - e.g., 90 days; or
 - e.g., cumulative period of 90 days in any 12 month period
- If a licensed medical physician chosen by the Franchisor so certifies
- If a licensed medical physician approved by both parties so certifies

Franchisor's Rights

- Upon “succession event”, Zor may wish to reserve the right to:

-  Purchase the franchise from the estate or representative

-  Itself manage the franchise for an interim period

-  Appoint a manager (from the franchise) for the franchise for a temporary period of time

-  Require the estate or representative to sell the franchise to the remaining shareholders

...

Franchisor's Rights cont.

...

-  Require the executor or representative to appoint its own manager pending the sale of the franchise to a third party acceptable to Franchisor
-  In the case of the death or permanent disability of the last remaining shareholder, require the estate or representative to sell the franchise to an arm's length third party acceptable to the Franchisor within a certain period of time
-  In the worse case scenario, terminate the franchise agreement

Interim Management



Franchisor may wish to reserve the right to manage the franchise itself:

- for an interim, pre-determined period of time
- for so long as it deems reasonable
- **Duration of Interim Period**
 - Until such time as an acceptable successor is identified
 - For such time that is required to wind down the franchised business

Interim Management cont.

 To appoint a manager as its agent from the franchisee's operation who:

- has completed Franchisor's training
 - is otherwise acceptable to Franchisor
 - signs a confidentiality and non-competition agreement with Franchisee
 - is paid directly by the franchisee
 - Agrees to indemnify Franchisor
- Administrative fee deducted from revenues

Interim Management cont.

 To appoint its own manager

- Administrative fee may be charged by Zor and deducted from revenues

Interim Management cont.

- In each case, Franchisor should:
 - Establish a separate account for all revenues generated
 - Account to the Zee for same less expenses and its administrative fees
 - Keep accurate records of the franchised business while under its management or control
 - Ensure that insurance is in place

Franchisor's Right of Repurchase

- Within a certain designated period of time
- Confirm that the estate or representative is authorized to sell the franchise
- Upon a pre-established purchase price:
 - At fair market value, determined by reference to the income and asset value of the franchised business as a going concern, yet excluding goodwill associated with the Marks
 - “Asset Value” – Inventory (actual cost, exclude damaged inventory), Fixtures, Equipment and Furniture (Net Depreciated Book Value)
 - Such other agreed upon basis

Franchisee's Right to Sell Franchise...

- Franchisee's estate or representative may have a right to sell the franchise
 - Subject to:
 - Approval of transferee by Franchisor
 - The transferee meets the Franchisor's standard terms and conditions for transfer
 - Transfer fee?
 - Franchisor's right of first refusal

Franchisee's Right to Sell Franchise...

- Estate or representative may have a right to transfer to a spouse or other relative of deceased or permanently disabled franchisee/guarantor
 - Within a designated period of time, failing which the right is extinguished
 - Provided that:
 - such transferee meets the transfer conditions
 - the estate or representative guarantees the obligations of such transferee
 - Usually no transfer fee would apply

Franchisee's Right to Sell Franchise...

- Query what happens if the Franchise Agreement conflicts with the terms of the Will of the deceased?
See Greenwood decision

Franchisor's Right of Termination

- Franchisor may reserve the right to terminate the franchise agreement should the estate or representative fail to:
 - Present a transferee acceptable to Zor
 - Transfer the franchise,
within a certain period of time

Legal Tips...

- ❑ Draft succession and change of control provisions very carefully (to provide flexibility and to maintain control)
- ❑ Institute procedures to enforce the franchise agreement

Legal Tips...

- Demand a Certificate of Incumbency and copies of relevant documentation in the FA
 - Shareholders Agreement, Partnership Agreement etc.
- Transfer provisions should control intra-franchisee transfers and replacement of managers
- Impose a continuous reporting obligation on Zees to disclose all shareholders & managers involved in the franchise

Legal Tips

- ❑ Share certificates should be endorsed with stop transfer instructions
- ❑ Articles of incorporation and by-laws
- ❑ The franchisee's failure to comply should constitute an event of default
- ❑ Franchisee should indemnify Franchisor for any liability incurred while managing the franchise on an interim basis
- ❑ Irrevocable Powers of Attorney from franchisee may be useful

Conclusion

Joseph Adler

Hoffer Adler LLP

www.intelligentfranchising.com

(t) 416-977-3444

©Hoffer Adler LLP, 2008

