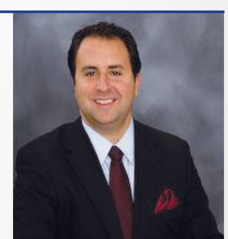
Plan Your Legacy With a Succession Plan Your Franchisor Will Approve


by Justin Klein

"Everyone must leave something behind when he dies, my grandfather said. A child or a book or a painting or a house or a wall built or a pair of shoes made. Or a garden planted. Something your hand touched some way so your soul has somewhere to go when you die, and when people look at that tree or that flower you planted, you're there." Ray Bradbury, the author of the American classic "Fahrenheit 451," could just as easily have included "business" in his list of items to leave behind. Indeed, passing a business on from generation to generation could be the guarantee of safeguarding one's legacy well beyond their involvement in a business they started.

Yet, surprisingly, most business owners fail to appreciate the reality that one day they may not want to run their business anymore or, worse, can't. Why? My guess (as a business owner) is that, like me, they are focused on running their business day to day as smoothly and profitably as possible and assume that the future will handle itself. However, with a solid succession plan, a business owner can ensure that the business lives on once he or she is gone. As they say, "Failing to plan is planning to fail." This article focuses on one key aspect of succession planning for a franchise owner – franchisor approval.

Often, a business owner's estate planning goals drives his or her succession plan. In reality, the first time many business owners pay attention to their exit strategy is when they are drafting a will or working on tax planning. Generally, the objectives of an individual's estate plan include: (1) maximizing the use and benefit of property during his or her life; (2) minimizing taxes; and (3) promoting an orderly transfer of property in accordance with his or her goals. And, while those considerations are important to creating a solid estate plan, succession planning also involves critical issues like: Who, besides me, is the best person to run my business? Who can continue to maximize the benefits of the business and carry out the goals I have set? Who wants the responsibility?

As a franchisee, like any business owner, the answer to these questions requires careful deliberation. However, as a franchisee, there are additional concerns beyond the everyday tax and estate planning issues. In fact, there is one major force that is all too often overlooked when contemplating what will happen to the business if it can no longer be operated by the original business owner – the franchisor. That is, while someone might have the best intentions when crafting his or her succession strategy, if the plan is not one that will be approved by the franchisor, then it was all for naught. Failing to create a plan that the franchisor is on board with can not only lead to stress and anxiety for those intended to take over the business but, in a worst-case scenario, can lead to a loss of the business altogether.

Note, a very simple strategy can be adopted to avoid this situation, which is to: (1) make sure you are aware of what your franchise agreement permits; (2) create a plan that is approvable by your franchisor; and (3) make sure that your franchisor is aware of your plan and agrees with its implementation.

In virtually every franchise agreement, there is a provision that restricts the transfer of a franchise without the franchisor's approval. For example, Section 13 of the Planet Fitness® form franchise agreement (2017) includes the following section:

> **13.2 BY YOU.** You understand and acknowledge that the rights and duties created by this Agreement are personal to you (or, if you are a corporation, partnership, or other entity, to your Owners) and that we have granted the Franchise to you in reliance upon our perceptions of your (or your Owners') individual or collective character, skill, aptitude, attitude, business ability, acumen and financial capacity. Accordingly, neither this Agreement (or any interest therein) nor any ownership or other interest in you or the BUSINESS, including any arrangement whereby you sell or pledge accounts receivable, EFT, or any other assets of the BUSINESS, may be transferred without our prior written approval. Any Transfer without such approval constitutes a breach of this Agreement and is void and of no effect.

Generally, this provision is included so that a franchisee does not sell its franchise to a third party that the franchisor does not approve of. A restriction on transfer will also apply in situations where the franchisee becomes incapacitated or deceased. The franchise agreement incorporates the following language to addresses this type of scenario:

> **13.5 TRANSFER UPON YOUR DEATH OR DISABILITY.** Upon your death or permanent disability or, if you are a corporation or partnership, the death or permanent disability of the Owner of a controlling interest in you, your or such Owner's executor, administrator, conservator, guardian or other personal representative must Transfer your interest in this Agreement or such Owner's interest in you to a third party. Such disposition of this Agreement or the interest in you (including, without limitation, Transfer by bequest or inheritance) must be completed within a reasonable time, not to exceed six (6) months from the date of death (or if later, such date that such Transfer may be legally completed) or permanent disability, and will be subject to all of the terms and conditions applicable to Transfers contained in this Article. A failure to Transfer your interest in this Agreement or the ownership interest in you within this period of time constitutes a breach of this Agreement. For purposes hereof, the term "permanent disability" means a mental or physical disability, impairment or condition that is reasonably expected to prevent or actually does prevent you or an Owner of a controlling interest in you from managing and operating the BUSINESS for a period of three (3) months from the onset of such disability, impairment or condition.

Understanding and appreciating what the franchise agreement permits is an important first step. Next, you must determine who can or will succeed you (of course, there are a number of estate planning and tax-specific matters to consider during this step as well). Often, this is a child of the franchisee. To that end, some franchisors have gone as far as creating a Succession Plan Manual explaining the company's policy in this arena. McDonald's, for example, has created the "Next Generation Process." This 20-page blueprint introduces McDonald's philosophy on succession planning within the family and maps out the approval process for "sons and daughters of owner/operators, including sons-in-law, daughters-in-law and step children." In most instances, however, there is no manual to follow. As such, if a franchisee desires a family member to succeed them as the owner, one suggested course of action is to have that family member approved by the franchisor as an owner/operator prior to the franchise agreement being signed or at least while the franchisee is still in control of the business.

If the plan is to leave the business to a key employee or, for example, a spouse, likewise, that individual should be approved by the franchisor at the earliest time possible. And, whether it is a family member or an employee, or someone else that will assume the business, it is vital that they are aware that they stand to inherit not just the financial benefits of running the business, but also each of the financial and performance obligations that go along with running such business. That is, make sure that they are familiar with the franchisor's policies and procedures, as well as the ins and outs of how the business was run prior to the succession. Most importantly, communicate your plan with your franchisor so that there are no surprises in the 11th hour. This way, everyone is prepared for the transition when it does occur and that any interruptions to the business – which can detrimentally impact both the franchisee and franchisor – are minimized to the greatest extent possible.

Having a succession plan in place is vital to the continued success of a business when you are no longer there to operate it. Ensuring that your franchisor approves of your plan is an easy way to make sure that your wishes are carried out, and that the business will continue to thrive despite your absence.

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