

# Succession Planning that Your Franchisor Will Approve



“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 have just as easily included “business” in his list of items to leave behind. Indeed, if done right, passing a business on from generation to generation could be the guarantee of safeguarding one’s legacy well beyond founder involvement in the business itself.

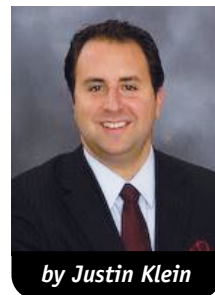
Yet, surprisingly, most business owners fail to appreciate the reality that one day they may not want to run their business anymore, or worse, can’t. Why the lack of planning? My guess (as a business owner) is that, like me, they are focused on running their business day to day as smoothly and profitably as possible and assume that the future will handle itself. However, with a solid succession plan, a business owner can avoid sudden wealth destruction while ensuring that the business has a chance to live on once he or she is gone. As the saying goes, “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 drive his/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/her life; (2) minimizing taxes; and (3) promoting an orderly transfer of property in accordance with his/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?,” and “Who wants the responsibility?” If those questions do not motivate you sufficiently to plan, then consider further the equally important question to ask: “What would happen to my business if something suddenly happened to me?”

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 succession, 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/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.

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 2025 Planet Fitness® form Franchise Agreement 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 an 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, you shall ensure that no Transfer shall occur without our prior written approval, subject to Article 13.4. Any such unapproved Transfer constitutes a material breach of this Agreement and is void and of no effect. Any Transfer of ownership, possession or control of the BUSINESS, which for the avoidance of doubt, includes, for example, a pledge, collateral assignment or grant of a security interest in this Agreement in connection with any transaction, is subject to compliance with this Article 13.



by Justin Klein

*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.*

Generally, this provision is included so 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 address this type of scenario:

13.3 TRANSFER UPON YOUR DEATH OR DISABILITY. Upon your death or Permanent Disability or, if you are an Entity, the death or Permanent Disability of an 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 13. A failure to Transfer your interest in this Agreement or the ownership interest in you within this period of time constitutes a material breach of this Agreement.

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 planning manual explaining the company's policy in this arena. One such franchisor, famous for hamburgers, fries and shakes, for example, created the "Next Generation Process." This 20-page blueprint introduced that franchisor's philosophy on succession planning within the family and mapped out the approval process for "sons and daughters of owner/operators, including sons-in-law, daughters-in-law and stepchildren." 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

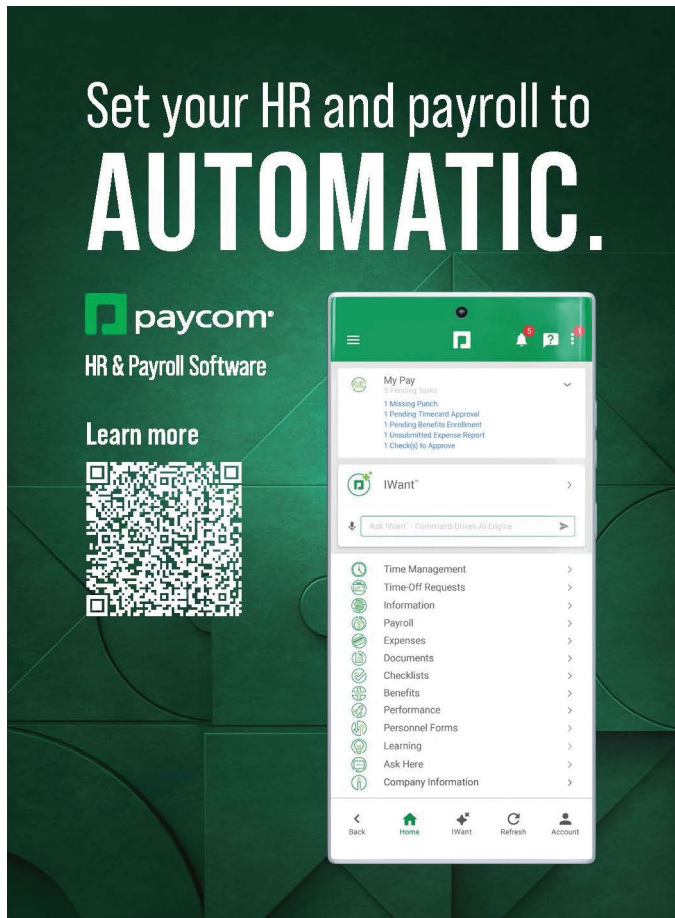
example, a spouse, likewise, that individual should be approved by the franchisor at the earliest time possible, or at a minimum, likely approvable when presented eventually as a candidate. Whether it is a family member or an employee, or someone else that will assume the business, it is vital that they 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 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 franchised business when you are no longer there or able to operate it. Ensuring that your franchisor approves or at least should be reasonably expected to approve 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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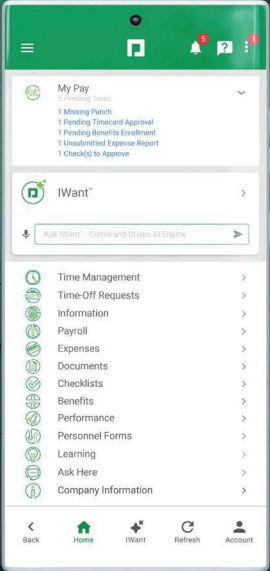
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