Farrell Fritz, P.C.

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Focus on Franchising

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Welcome!

It's summertime and, as the saying goes, the "living is easy". . . but not necessarily for our nation's busy franchisors! With franchising continuing as a very active force in the U.S. economy, many franchise leaders are no doubt working overtime to meet the challenges of their growing businesses. In this, our fourth edition, we hope to help ease your burden and sharpen your growth strategies with some interesting and timely articles. As always, your comments are welcomed at franchise@farrellfritz.com.

James M. Wicks,Esq.
Harold L. Kestenbaum, Esq

Inside

Zoning Laws May Not Be Used To Regulate Business Hours

By Anthony S. Guardino, Esq.

The business model of many franchised businesses requires the franchisee to remain open for business beyond so-called "traditional" business hours. In many instances, franchise agreements for fast-food restaurants, convenience stores and donut shops require franchisees to operate late into the evening and early morning. Some franchisors obligate their franchisees to operate 24/7.

Although expanded hours may be profitable, some local lawmakers harbor the belief that late-night businesses attract an undesirable element. As a result, many municipalities have attempted to prohibit or restrict these uses by adopting zoning laws restricting business hours.

In New York at least, local zoning regulations that attempt to limit hours of operation are typically rejected by the courts on the basis that they are not a valid exercise of zoning power. In essence, these courts characterize such zoning restrictions as an improper attempt to regulate the internal operation of a business, rather than as a valid land use regulation.

For instance, a landowner and its lessee, 7-Eleven, Inc., which planned to operate a convenience store on the property, brought an action to invalidate a local law prohibiting operation from 11 pm to 6 am for any business within 100 feet of a residential zoning district. The court sided with the franchise and held that a village's zoning authority is limited to items that bear some relation to the physical use of land. The court also observed that there is a dichotomy between regulations that directly relate to the physical use of land and those that regulate the manner of operation of a business or other enterprise.

In defense of its law, the village argued that it was regulating a new category of land use, namely, the 24-hour use; and it cited the negative impact of such land use upon neighboring residential property. The court, however, rejected the village's argument that the zoning law was more aptly characterized as a regulation of land use than as a restriction on the internal operation of a business. The court noted there was no evidence that overnight business operations per se had a greater impact on neighboring properties than such business operations did during regular business hours. Accordingly, the court held that, absent

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Franchise Briefs

By Harold L. Kestenbaum, Esq.

There have been no earth-shattering developments that I can report to you at this time, although many franchisors anxiously await the decision in the Dunkin' Donuts restrictive covenant case. When it is handed down, we will report on how the appellate court decided the case. Also, there is nothing new on when the FTC will finally issue its proposed changes to its FTC Rule. So, for the time being, the status is quo on changes to be made to every franchisor's UFOC.

Kudos!

Our Focus on Franchising electronic newsletter won a prestigious Gold prize at the 31st annual "BOLI" (Best on Long Island) advertising awards, held by the Long Island Advertising Club in May. The awards, judged by nationally prominent leaders in the advertising and marketing industry, are considered the "Oscars" for advertising on Long Island. Congratulations to our writers and staff!

Three Ways A Loan Broker Can Help Close Franchise Sales

By Bernie Siegel

I have found that the single most prevalent reason prospective franchisees interested in a specific system do not move forward with signing a franchise agreement is they are just not sure they can raise the necessary funds to complete the project. Franchisors can help move the process along by referring their franchisees to a loan processing/broker service. These firms can offer the following strong advantages:

1. Finding The Right Lender

First, a professional loan service will typically pre-qualify the prospect, without any fee or obligation. They will review the specific franchise and the strength of the prospect and talk directly with the lender to whom they anticipate the loan request will be sent. If the first lender chooses not to handle the account, the broker moves on to the next lender. This way, the prospect never hears the "no's". . . only the eventual "yes."

2. Preparing The Right Plan

Loan brokers typically prepare the business plan to be submitted to the lender. Most prospective franchisees, left to their own devices, usually create a projection that is so conservative the lender cannot approve the loan. Brokers know how to be realistic on costs but project sufficiently rapid business growth to meet the lender's cash flow criteria.

Here is a real life example that came across my desk in April. A prospective franchisee for a tutoring franchise submitted his own loan package to the largest SBA lender. The franchise system had a very good SBA record; and normally, a properly packaged application is approved, regardless of collateral. But the projection was much too conservative, and the underwriter had to reject it. Once it was rejected, the lender would not reconsider the loan request, even with a modified business plan.

3. Structuring The Right Deal

Loan brokers can also provide creative deal structuring. A knowledgeable loan intermediary will often be able to suggest certain partnership structures or equity lines to protect the assets of some or all of the partners. This can be key to the prospect's decision to move ahead with the transaction. Without this input, the prospect may choose not to proceed with the deal. In addition, the

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partnership structure may be critical to the ability of the franchisee to borrow additional funds in the future. This becomes crucial with more capital-intensive franchises, especially with multi-unit franchisees. Prospects who work directly with a lender will not receive this critical counseling.

In short, a loan broker makes the process go smoother and faster, allowing the franchisee to concentrate on site selection, building plans, staff development, franchisor training and other pre-opening tasks. The broker insures that the money will be waiting for the contractor, not the contractor waiting for the money!

Bernie Siegel is President of Siegel Capital LLC, a loan brokerage firm based in Bala Cynwyd, PA, that can provide financing anywhere in the U.S. and Puerto Rico. The firm's management has 29 years of experience in franchising. For additional information, please visit www.siegelcapital.com.

LITIGATION NOTES

How Useful Are Liquidated Damages Clauses in Franchise Agreements?

By Michael J. Healy, Esq.

Limiting the risks, expense, frustration and inefficiencies of litigating franchise disputes should be a goal of both franchisors and franchisees alike. Clauses and provisions designed for just that purpose are now commonplace in franchise agreements. Typical examples include arbitration clauses, choice of law provisions, and waiver of jury trial clauses. One increasingly common provision is the liquidated damages clause. But just how useful, or desirable, is this provision?

A liquidated damages clause is, in essence, a contractual stipulation of the precise dollar amount, or a formula for calculating the precise dollar amount, that one party can receive as damages in a lawsuit against the other party on specified claims under their contract. Unless the amount fixed is plainly or grossly disproportionate to the probable loss, courts in most states enforce these provisions as long as the amount liquidated as damages is reasonable in proportion to the probable loss and the amount of the actual loss is incapable or difficult of precise estimation.

No liquidated damages clause can solve every damage issue that might arise in franchise litigation. But including this provision can offer a franchisor a number of benefits. By establishing a fixed amount of damages for breach of contract claims - for example, claims for lost profits, harm to intellectual property, or damage to good will - this clause enables a franchisor to forego the need to engage and depose experts and devote time, both in discovery and at trial, in attempting to prove future damages or lost profits. The franchisor's overall litigation expenses are thereby capped while permitting it to know precisely what it will be awarded if its claim prevails.

At the same time, by including a provision setting forth the precise amount of damages for breach of the franchise agreement, the franchisor also avoids the risk that expert testimony, otherwise necessary to prove lost profits or other damages, might be deemed speculative.

The franchisee, of course, stands to benefit as well. For example, in the case of premature termination of the franchise agreement, the franchisee avoids a judgment for lost profits covering the entire remainder of the term of the agreement and can estimate its potential liability if it decides that it is no longer feasible to operate its franchise business.

The ultimate decision on whether to include a liquidated damages clause in a franchise agreement largely depends on the nature and particularities of the franchisor's business and on whether the franchisor wishes to limit the amount of damages that it may actually incur from a franchisee's breach of the parties' agreement. Overall, though, this clause offers both franchisors and franchisees concrete benefits and establishes the parties' expectations at the outset regarding possible disputes arising from a breach of their agreement. In the process, it also facilitates the evaluation of those disputes and the risks of potential litigation.

In the end, a franchisor should consult counsel in assessing how and what type of liquidated damages clause might be useful to include when drafting franchise agreements.

Our firm is pleased to welcome Kevin McElroy, Esq., and Robert C. Yan, Esq., as Associates in our Commercial Litigation Practice Group.

On June 28, our New York City office relocated to 600 Third Avenue, 18th Floor, New York, NY 10016.

Zoning Laws

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substantial evidence showing the external impact of the land use in question, a restriction on hours of operation had to be deemed an impermissible attempt to regulate the details of the operation of a business. As such, the trial level court held that the local law represented an invalid exercise of zoning power, thus striking it down. This decision was later affirmed on appeal.

While that case represents a victory for franchise operators seeking to operate late into the night, the case cautions that not all challenges to laws that restrict hours of operation may be successful. It is clear, however, that a local zoning regulation attempting to regulate business hours is likely to be invalidated, especially if it does not have a sufficient nexus to the physical use of land.

Events Calendar

September 10
Farrell Fritz Quarterly Franchise Forum
To reserve a place, contact Helen Rajcooar: phone, 516-227-0641; email, hrajcooar@farrellfritz.com

November 5
Farrell Fritz Franchise Forum in Tampa, FL
To reserve a place, contact Harold Kestenbaum: phone, 516-227-0642; email, hkestenbaum@farrellfritz.com

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