Franchising and Distribution Agreements

Yair and Ron are friends. They've always dreamt of setting up shop and running an independent business. A mutual friend introduced them to Avi, the owner of a successful company. Avi's company is in the business of importing and marketing upscale fashion brands. Avi was looking for franchisees that would setup a new branch.

After some discussion, Avi handed Yair and Ron a "Franchising and Distribution Agreement." This 15-page document specified the various responsibilities Yair and Ron will assume towards the company.

Yair and Ron sought legal counsel. They wanted to know which are the most important clauses in this type of agreements, and whether there might be some "potholes" they should avoid.
In a franchising agreement, one of the most important clauses to be aware of is the "non-compete" clause. In other words, what is the size of the franchise' territory - the distance from the franchise within which no other franchises can be sold or setup. These other franchises would potentially directly compete with our franchisee.

One should demand the franchisor (the "Franchise Network") to make a clear and firm commitment to provide advertising as well as signs and other professional marketing materials. In many contracts, the franchisee is required to pay the franchisor a percentage of sales revenues. In these cases, the franchisee most certainly has the right to demand that the franchisor be responsible for all advertising services, etc.

The clause defining the franchise term is a very important one. Usually, the franchisee is charged a hefty upfront franchise fee (sometimes up to tens or hundreds of thousands of dollars). Accordingly, she should demand the network agree to a franchise term long-enough to allow for the return of this investment. Additionally, one must insist the franchise will be renewable. In other words, if the original term is for 5 years, one should ensure the franchisee has the right to ask for an extension of this term.

Another clause that may put the franchisee in a hard spot is one stating the obligation of the franchisee to purchase all inventory only from the networks' authorized providers. Although this might seem as an innocent request, in actuality, the authorized provider may charge significantly more than market prices. The network will be the one profiting from this difference between market prices and the prices fixed by the contract.

The parties reached an agreement and signed the franchising contract. In only a few years, Yair and Ron became extremely successful.

Several weeks ago, Avi sent them a short message, indicating that "according to a re-examination of the network's policy, the franchise is terminated effective immediately."

Yair and Ron were puzzled, and turned to an examination of the agreement they signed with Avi. They quickly found that the franchising agreement did not specify a term. If their business is closed, are Yaron and Avi entitled to damages due to this abrupt termination of the agreement on Avi's part?"

In various instances, The Supreme Court ruled that the termination of a distribution agreement is subject to due notice. With respect to the time required for this notice, the principle rule is that the duration should be set to allow the marketer to return their investment. In the case of Moshe Zohar v. Travenol Labs Inc. (civil appeal 442/85), a reasonable notice was deemed to be 1 year long. In this case, where the agreement was unilaterally terminated, the marketer was entitled to damages equal to the profits accrued in one year.

Therefore, Yair and Ron are undoubtedly entitled to be compensated for this abrupt termination of the agreement.