

# **My view | Franchise lessons learned from the Auto Industry Bankruptcy Debacle**

BY ROBERT ZARCO

Special to the Miami Herald

The recent bankruptcies of auto-industry giants Chrysler and General Motors have brought important issues regarding the franchisor/franchisee relationship to the headlines. Franchisees depend on their franchisors for many vitals, such as product inventory, marketing/advertising, brand name recognition in the marketplace, and other forms of support. Most franchise agreements have a duration of fifteen to twenty years or longer, so franchisees are obviously counting on the fact that the franchisee/franchisor relationship, where each party is dependent on the other, is going to last a long time and survive unexpected glitches and nuances that arise over time.

One of those glitches is the unwelcome filing of bankruptcy by the franchisor. If a franchisor files for bankruptcy, it will be required to either “accept” or “reject” its existing ongoing franchise agreements. If the franchisor accepts a particular franchise agreement, it will be business as usual between the parties going forward. The court, however, may allow the franchisor to “disavow,” or reject, certain of its franchise agreements as part of the reorganization if the franchisor claims that it is in its best interests to do so. In this situation, the rejected franchisee suddenly and unexpectedly finds himself essentially put out of business.

If you are a franchise business owner, pay attention now to whether your franchisor is starting to face or is currently experiencing financial difficulties. You might notice a reduction in the number of field personnel visiting your business, a reduction of expenditures in marketing and advertising programs, or cutbacks in the research and development of new products. Corporate locations can also provide insight into the franchisor’s financial status: if you perceive poorly maintained and rundown corporate locations, a reduction of support employees at corporate headquarters, or a slowdown in corporate growth and expansion, these may be an indicator of an imminent bankruptcy filing.

Preemptive measures should be undertaken immediately to protect the franchisee’s interests. They include: confirm that your operation is running lean and mean as a tight financial ship. Reduce your excess labor without compromising service. Reducing in-store inventories to a necessary but minimum level will protect the franchisee against the risk of being swamped with unusable or unsellable stock in the wake of an unexpected termination.

Of course, this must be counter-balanced by the concern of continuing as a viable independent business. If the franchisor is your primary supplier of product, this chain of supply will be cut off if your franchise agreement is singled out for rejection in a bankruptcy. If you intend to carry on a similar business after a termination, it may not be wise to drastically reduce inventory. Furthermore, efficient use of labor, quantity of inventory, and the physical appearance of the franchisee’s location may factor into the franchisor’s decision of whether to assume the franchise contract or to reject it.

In certain cases, the best thing for a franchisee to do may be to try to sell the business, even for less than its present market value. Even if the business is sold for a “fire sale” price, the proceeds are likely guaranteed to be greater than what a franchisee could expect to obtain as rejection damages out of the franchisor’s bankruptcy.

Such precautions are essential because, should the franchisor file for reorganization, a franchisee’s options will be severely curtailed once the complicated laws of bankruptcy kick in. This leads to the single most important step the owner of a franchise business can take to protect its best interests—retain legal counsel that specializes in franchise law, and has working knowledge in bankruptcy law. The lawyer who handled your divorce or the real estate closing on your home will simply not be prepared, nor have the necessary requisite experience, to provide competent legal counsel in a high stakes situation. A franchise legal expert can guide the franchisee through the treacherous legal waters likely to be encountered in a bankruptcy. Just because a franchisor rejects a franchise contract in bankruptcy, it is not necessarily the end of the line for the rejected franchisee. An experienced franchise attorney will know that the franchisee is entitled to sue the franchisor for rejection damages, and will take all measures necessary to insure that the franchisee emerges on the other side of its franchisor’s bankruptcy with the best possible result. A franchise legal specialist can even help franchisees prepare a solid strategy before a franchisor bankruptcy transpires. In these precarious times, a franchisee simply cannot afford to rest on its laurels. As we have learned from the bankruptcies of Chrysler and G.M., a franchisee’s best defense is to pro-actively seek out in advance what its rights and options are in the face of a franchisor bankruptcy; they are out there.

*Robert Zarco is an internationally recognized franchise legal expert and speaker. He is also the founding partner of Zarco Einhorn Salkowski & Brito, P.A., a leading law firm specializing in franchise, licensing, dealership, and distribution law. Based in Miami, Florida, Mr. Zarco represents franchisees from hundreds of different franchise systems throughout the United States and internationally.*

*The author would like to thank Mikhael Ann Buchanan, an attorney at the law firm of Zarco Einhorn Salkowski & Brito, for her contributions to this article.*