

SEPTEMBER 19, 2024

ESTATE PLANNING FOR FRANCHISEES: ENSURING A SMOOTH TRANSITION

Authors: John Doroghazi, Matthew E. Smith and Andrew S. Philbin

*If you have any questions
about this Advisory,
please contact:*

MICHAEL T. CLEAR
203.363.7675
mclear@wiggins.com

ROBERT W. BENJAMIN
212.551.2602
rbenjamin@wiggins.com

DANIEL L. DANIELS
203.363.7665
ddaniels@wiggins.com

SETH E. ELLIS
561.910.7510
sellis@wiggins.com

HELEN C. HEINTZ
203.363.7607
hheintz@wiggins.com

DAVID W. KESNER
203.498.4406
dkesner@wiggins.com

LEONARD LEADER
203.363.7602
lleader@wiggins.com

VANESSA L. MACZKO
203.363.7667
vmaczko@wiggins.com

ERIN D. NICHOLLS
203.498.4319
enicholls@wiggins.com

CAROLYN A. REERS
203.363.7668
creers@wiggins.com

As the owner of a franchise, you may be focused on the day-to-day operations and management of the business. You might have plans for the longer-term, for growing the business in the years ahead. But what if you are no longer around? Who will operate it? And who will inherit it? Would you prefer that the business be sold on your death? For each of those questions, are you certain that your wishes will be recognized and approved by the franchisor?

Estate planning for franchise interests often requires thought and care. For lifetime planning, careless work (often a unilateral transfer to an LLC or a trust) could result in a deemed “unauthorized transfer” that risks violation of the franchise agreement and termination of the franchise. On the death of a franchisee, it is not simply a matter of removing the franchisee’s name and adding the name of a family member.

The Franchise Interests. Franchise interests are unique assets. They are property rights that derive from a contract between the franchisee and the franchisor. They involve the use of famous and highly protected brands. For that reason, and depending on the nature of a franchisee’s wishes, estate planning may require the awareness and consent of the franchisor to be effective. Estate planning cannot always be done unilaterally by the franchisee. For example, if a franchisee wishes to transfer his or her interest to an LLC during life, that transfer will almost certainly require consent of the franchisor. Planning should be done in a manner that is consistent with the governing franchise agreement or it risks triggering adverse consequences for a franchisee or a franchisee’s family.

The Franchise Agreement. The governing franchise agreement often is the first place to look when undertaking any planning with franchise interests. The franchise agreement may contain terms and restrictions related to any of the following:

- Planning for management of the franchise during your life, such as whether the franchise may be held in a corporate entity, such as an LLC;
- Whether the franchise may be held in a revocable (or “living”) trust;
- Who may operate the franchise in the near-term (or long-term) event of your death; and
- The process for identifying and qualifying a successor franchisee.

Planning During Life / Corporate Entities. Many franchisees will seek to transfer franchises into corporate entities, such as LLCs, during their lives. Similarly, many franchisors allow for corporate entities to be the franchisee when a franchisee joins the system, but have many rules regarding how those entities can be owned and/or

CONTINUED

ESTATE PLANNING FOR FRANCHISEES

MATTHEW E. SMITH
203.363.7639
msmith@wiggins.com

GEORGE R. FREUND
561.910.7512
gfreund@wiggins.com

SCOTT G. RICHMAN
561.910.7516
srichman@wiggins.com

KATERYNA BAKHNAK
212.551.2855
kbakhnak@wiggins.com

MARY MARGARET COLLEARY
212.551.2637
mcolleary@wiggins.com

VICTORIA FIENGO
212.551.2634
vfiengo@wiggins.com

RUTH FORTUNE
203.363.7658
rfortune@wiggins.com

ASHTON C. MALKIN
561.910.7511
amalkin@wiggins.com

MARISSA A. O'LOUGHLIN
203.363.7674
moloughlin@wiggins.com

KAITLYN A. PACELLI
203.363.7635
kpacelli@wiggins.com

ANDREW S. PHILBIN
203.363.7606
aphilbin@wiggins.com

MI-HAE K. RUSSO
212.551.2619
mrusso@wiggins.com

transferred. In both scenarios, a transfer of the franchise interest from a person to an entity or how to structure the ownership of the entity may require approval of the franchisor or could be deemed an "unauthorized transfer," which could risk termination of the franchise. In many cases, where a franchisee seeks to do lifetime planning with corporate entities, the franchisee and planning counsel will need to work together with the franchisor to have the proposed transfer reviewed and approved. This often requires providing all governing documents to the franchisor, and the franchisee may be required to serve as a personal guarantor.

No Estate Planning: Intestate Succession and Franchises. When an individual dies without an estate plan (the individual has never signed a will, for example), the "intestacy" law of the home state will govern the disposition of estate assets. It is often the case that a surviving spouse and descendants all share in the assets of an "intestate" estate, and that administration of the estate will be overseen by a probate court. This can create unique problems with franchises. If the intent is to keep the franchise in the family, then one or more of the "heirs-at-law" likely will need to qualify as a new franchisee, and it is possible that they may not be approved. With the exception of few states that have franchise specific laws relating to inheritance of a franchise, the issue of what occurs with the franchise interest at death is controlled entirely by the contract. It also is possible that intestacy will force a sale of the franchise because the franchise cannot be divided among multiple heirs. Even if the ultimate disposition of the franchise could be sorted out with the probate court and the franchisor, there can be a more immediate concern with an intestate estate: the franchise may have no clear operator in place during the pendency of the estate, which could risk termination because a trained franchise operator is necessary under the franchise agreement.

Estate Planning with Franchises. For the reasons above, the owner of a franchise should be thoughtful and intentional when engaging in estate planning. It is important that the estate plan squares with the franchise agreement and, if necessary, is reviewed and approved by the franchisor in advance. The nominated executor should be able to operate (or manage the operations of) the franchise during the pendency of the estate, and it should be clear who should inherit the franchise on the franchisee's death. If the intent is to pass all assets to a surviving spouse in trust, for example, a bequest of the franchise should be carved out of that planning unless the franchise agreement permits ownership in trust. If ownership in trust is a permissible option, then it is worth thinking in advance on how it will work. For example, will the trustee need to qualify as the franchisee, or is the franchisor willing to recognize the beneficiary-spouse as the franchisee? Will anyone need to offer a personal guaranty? And is it possible to tee up any of the estate work in advance? A franchisee also might explore whether the franchisor is willing to recognize ownership of the franchise in a revocable (or "living") trust, to minimize or avoid probate.

Wiggin and Dana, which has experiences advising both franchisors and franchisees, is well-versed in estate planning for franchisees and can walk you through an effective plan to preserve the value generated by your hard work.

This publication is a summary of legal principles. Nothing in this article constitutes legal advice, which can only be obtained as a result of a personal consultation with an attorney. The information published here is believed accurate at the time of publication, but is subject to change and does not purport to be a complete statement of all relevant issues.