Preferred supplier terms - tips for franchisees

Tips for Franchisees - preferred supplier terms article is the first in a series of 5 articles written by Bill Morgan to help franchisees understand the importance of reading through thoroughly the franchise agreements and asking any questions prior to signing this agreement. By being aware of the terms outlined in the contract, franchisees have a better understanding of what is expected and what their rights are in case of a franchise dispute. If you need advice on Franchise Agreements or if you are thinking of selling or not continuing with your franchise, please contact Bill Morgan.

What does 'Preferred Supplier terms' mean?

There are a number of matters that franchisees should consider when deciding whether to sign a franchise agreement and whether to acquire a franchise. In particular we often see again and again the same types of terms in franchise agreements that give rise to particular commercial risks to franchisees. Our focus in this article is on the commercial risks of what may be described as preferred supplier or approved supplier terms.

Some franchises provide for the supply by the franchisee to consumers particular goods or services. To sell these goods or provide these services, the franchisees need to acquire a certain product from other suppliers. For example, some franchises sell food or drinks such as bread, ice-cream, fruit juices or pies. They may need to acquire certain foods and ingredients. Other franchises provide cleaning, gardening or domestic services to consumers which require the franchisees to acquire chemicals or equipment to deliver these services.

If such a term is found in a franchise agreement then the franchisee must acquire the products from the preferred supplier otherwise the franchisee will be in breach of the franchise agreement. If the franchisee breaches the franchise agreement by not acquiring necessary products from a preferred supplier approved by the franchisor then the franchisor may have the right under the franchise agreement to terminate the franchise agreement and/or sue the franchisee for damages. The practical result of termination of the franchise agreement will be the end of the franchisee's business with no compensation to the franchisee for all the money and time he or she has invested in the franchise business.

By Commercial Litigation specialist Bill Morgan

"Franchise agreements often contain terms that oblige the franchisee to acquire the products necessary to conduct the franchise business and provide the goods or services of the franchise to consumers from preferred suppliers approved by the franchisor."

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Is there a benefit for the franchisee?

The apparent solution to avoid this commercial risk is to comply with the franchise agreement. However, in practical terms this may not be a solution for all.

Although franchisors will often assert that there is a benefit to the franchisee in using preferred suppliers, this assertion may not be necessarily correct. If a prospective franchisee is acquiring a franchise in a national chain consisting of numerous franchises there may indeed be a benefit in the franchisee acquiring goods from a preferred supplier. Due to the volume of sales that a supplier may be able to make to a large franchise chain the franchisor may have been able to make arrangements with the supplier to secure the supply of products to its franchisees at a very competitive price. Franchisors often describe this potential benefit to the franchisees in terms of bulk buying power.

There are a number of reasons why such an arrangement, that is potentially of benefit to the franchisee, may be detrimental to the franchisee:

1. If the franchise chain is not a large franchise chain there is no certainty that the franchisor will be able to secure from the franchisor's commercially competitive supply arrangements with suppliers. Even if it is able to enter into arrangements with suppliers that have commercial benefits there is no certainty that the franchisee would not have been able to make equally advantageous arrangements with the same supplier of other suppliers.

2. The franchisor may enter into commercially advantageous arrangements with the supplier but unknown to the franchisee those arrangements may confer the benefits provided by the supplier on the franchisor in the form of a kickback or incentive rather than on the franchisee.

3. Once the arrangement between a franchisor and a supplier is in place it may lock franchisees into acquiring goods and products at a price which is commercially competitive at the start on the arrangement but which becomes uncompetitive in terms of price during the course of the term of the franchise.

In summary, a prospective franchisee when faced with a franchise agreement containing preferred or approved supplier terms has a difficult decision to make.

If you are considering purchasing a franchise or if you have been given a Franchise Agreement and need advice, call us on 0473 667 426 or via our online enquiry form on our website at www.morganmac.com.au.

Our franchise law expert

Bill Morgan

About Bill Morgan

Our franchising law practice is led by Bill Morgan, who has over 20 years experience in all facets of commercial litigation matters such as franchise disputes, consumer protection, contractual disputes, property disputes, insolvency and bankruptcy proceedings.

Bill has acted over a number of years in disputes between franchisors and franchisees of franchises including Michele’s Patisserie, Pets Paradise, Frontline Recruitment, First Class Accounts, Cold Rock Ice Cream, Destiny Financial Services, Kleenit, Begin Bright, Yarra Valley Farms, Nutrition Station, Red Rock Noodle Bar, Home Icecream, Night Owl, Pizza Temptations, Express and Red Rooster. These disputes have been litigated in the Federal Court, Federal Circuit Court and State Courts or resolved through the mediation service provided by the Office of the Franchising Mediation Adviser. Bill is also a nationally accredited mediator and on the panel of mediators of the Office of the Franchising Mediation Adviser.

Bill’s focus is to offer and deliver exceptional service to his clients that is highly effective and cost-competitive.

Bill has provided advice to franchisees considering purchasing franchises such as StellaRosa Expresso Bars, Michele’s Patisserie, Pack & Send, John’s Nuts, F45 Training and Jim’s Cleaning. His advice deals with the legal and commercial risks and benefits of a prospective franchise agreement and assists franchisees to make relevant enquiries and seek key information before making a decision to acquire a franchise.

Call Today: 0473 667 426

PROUD MEMBER OF FCA FRANCHISE COUNCIL OF AUSTRALIA

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