Burr & Forman Partner Jeff Baker Featured in January issue of Franchising Business & Law Alert

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Jeffrey T. Baker

Baker provided his perspective regarding the control of many franchise systems by private equity or venture capital funds, or other investment groups:

"Most franchise systems were originally built around the concept of personal investment by individual entrepreneurs who would run the franchised business as an owner/ operator. Access to capital and other factors tended to keep growth rates moderate. Once franchisees started becoming large enough to attract investment by private equity funds and similar investors, we began to see a shift in the power dynamic between franchisee and franchisor. Private equity funds have the ability to put together complex capital structures that enable rapid growth, and growth is their game. In response to the potential economic threat posed by a system of very large franchisees run by investors rather than owner/operators, some franchisors have started to implement size limits on their franchisees.

Private equity funds generally prefer not to hold real estate in their portfolio companies because fee-owned real estate presents risk and valuation issues that can be difficult to quantify when calculating the fund's projected return on investment. As a result, many franchisees have found themselves in the position of pushing their operating properties into the sale-leaseback market in order to posture the business for sale. Careful attention must be paid to the assignment and change--of--control provisions embedded in such leases in order to make certain that the sale-leaseback landlord does not obtain unreasonable control rights that could

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limit the franchisee's ability to sell to a private equity fund or, more importantly, limit the private equity fund's exit strategy on the next turn of the company."