



## Understanding Franchise Agreements

### Issue:

This brief explains the manner by which a Franchise Agreement may impact a Veteran's ability to comply with the day-to-day operations and long-term decision makings requirements outlined in with 13 C.F.R. part 125.

(For purposes of this brief, the regulations when referring to Service-Disabled Veterans applies equally to Veterans; applicant refers to the business entity applying for verification; and participant refers to a business entity that has already been verified.)

### The Regulations:

**13 C.F.R. § 125.11** states “[d]aily business operations include, but are not limited to, the marketing, production, sales, and administrative functions of the firm, as well as the supervision of the executive team, and the implementation of policies.”

**13 C.F.R. § 125.11** provides:

*Veteran owned small business concern* means a small business concern:

(1) Not less than 51 percent of which is owned by one or more veterans or, in the case of any publicly owned business, not less than 51 percent of the stock of which is owned by one or more veterans; and

(2) The management and daily business operations of which are controlled by one or more veterans. All of the provisions of subpart B of this part apply for purposes of determining ownership and control.

**13 C.F.R. § 125.13(a)** states that “[c]ontrol by one or more service-disabled veterans means

that both the long-term decisions making and the day-to-day management and administration of the business operations must be conducted by one or more service-disabled veterans (or in the case of a veteran with permanent and severe disability, the spouse or permanent caregiver of such veteran).”

**13 C.F.R. § 125.13(i)** provides

*Control by non-service-disabled veterans.* Non-service-disabled veteran individuals or entities may not control the firm. There is a rebuttable presumption that non-service-disabled veteran individuals or entities control or have the power to control a firm in any of the following circumstances, which are illustrative only and not inclusive:

(1) The non-service-disabled veteran individual or entity who is involved in the management or ownership of the firm is a current or former employer or a principal of a current or former employer of any service-disabled veteran individual upon whom the firm's eligibility is based. However, a firm may provide evidence to demonstrate that the relationship does not give the non-service-disabled veteran actual control over the concern and such relationship is in the best interests of the concern.

(2) One or more non-service-disabled veterans receive compensation from the firm in any form as directors, officers or employees, including dividends, that exceeds the compensation to be received by the highest-ranking officer (usually CEO or President). The highest ranking officer may elect to take a lower amount than the total compensation and distribution of profits that are received

by a non-veteran only upon demonstrating that it helps the concern.

(3) In circumstances where the concern is co-located with another firm in the same or similar line of business, and that firm or an owner, director, officer, or manager, or a direct relative of an owner, director, officer, or manager of that firm owns an equity interest in the concern.

(4) In circumstances where the concern shares employees, resources, equipment, or any type of services, whether by oral or written agreement with another firm in the same or similar line of business, and that firm or an owner, director, officer, or manager, or a direct relative of an owner, director, officer, or manager of that firm owns an equity interest in the concern.

(5) A non-service-disabled veteran individual or entity, having an equity interest in the concern, provides critical financial or bonding support.

(6) In circumstances where a critical license is held by a non-service-disabled individual, or other entity, the non-service-disabled individual or entity may be found to control the firm. A critical license is considered any license that would normally be required of firms operating in the same field or industry, regardless of whether a specific license is required on a specific contract.

(7) Business relationships exist with non-service-disabled veteran individuals or entities which cause such dependence that the applicant or concern cannot exercise independent business judgment without great economic risk.

## What This Means:

- Subpart B as referred to in 13 C.F.R. § 125.11 is saying that anywhere in the regulations where the term Service-Disabled Veteran is used, it is equally

applicable to Veterans for purposes of determining eligibility.

- Franchise Agreements must follow the same regulatory requirements as are required of any Veteran-Owned business applying for the Department of Veterans Affairs Veterans First Contracting Program.
- Long-term decision making is conducted by Shareholders, Stockholders, General Partners, Managing Members and Boards of Directors. Long-term decisions are decisions that generally affect the direction the concern is headed such as adding a new line of business, purchasing a new headquarters building, mergers, and dissolution.
- Day-to-day operations are conducted by officers of the business such as Presidents, Managers, Vice Presidents, Chief Executive Officers, Chief Financial Officers, General Partners, and Treasurers.
- Examples of day-to-day operations of a business include marketing, production, sales, and administrative functions of the firm, as well as the supervision of the executive team, and the implementation of policies.
- A rebuttable presumption can only be defeated if sufficient evidence (i.e., a reasonable rebuttal) is produced that contradicts the facts that are stated as true.
- Provisions located in the applicant's Franchise Agreement cannot restrict the Veteran's ability to manage the daily business operations of the subject company.
- Generally, Letters of Explanation (LOE) will not defeat the provisions of a Franchise Agreement. If a Franchise Agreement restricts certain actions or requires that

certain actions be undertaken that do not comply with the requirements of 13 C.F.R. part 125, an LOE may not override the provisions of the Franchise Agreement. To resolve the deficiency, an applicant may have to submit an amendment to the Franchise Agreement.

### **Sample Provisions that do not comply with the regulations:**

- *Best Efforts and Full-Term Performance.* Only you are authorized to operate the Franchise. You specifically agree to be obligated to operate the Franchise, perform the obligations of this Franchise Agreement, and continuously exert your best efforts to promote and enhance the business of the Franchise for the full term of this Franchise Agreement. Except as specifically set forth in this Franchise Agreement, you may not delegate or assign any of the Franchise's rights or obligations under this Franchise Agreement or any aspect of the management or operation of the Franchise.
- *Managers.* All persons who offer services on behalf of the Business including you and your Program Managers are referred to as "Managers." You must obtain our prior approval before hiring any additional Managers.
- *Condition and Appearance of the Franchise.* You agree that:
  - (a) The Franchise will not be used for any purpose other than the operation of the Business without written approval by Franchisor and in compliance with this Franchise Agreement;
  - (b) you will maintain the condition and appearance of the Franchise, its equipment,

furniture, furnishings, and signs in accordance with our standards and consistent with the image of a Franchise Business (as the case may be) as an efficiently operated business offering high quality services, and observing the highest standards of cleanliness, and courteous service;

(c) you will promptly replace or add new equipment when we reasonably specify in order to meet changing standards or new methods of service.

- *Websites.* You acknowledge and agree that any website (defined below) will be deemed "advertising" under this Franchise Agreement. You agree and acknowledge that you are obligated to comply with our online policy which is subject to change by us from time to time. You agree and acknowledge that individual franchisee websites are prohibited, and that your online promotional strategies must comply with our online policy as contained in our Operations Manual. You further agree and acknowledge that we may review and monitor all online content on social media sites, blogs, electronic communication and other online sites on which our trademarks, service marks, trade names, copyrights or any similar marks are used. You agree to remove any usage or content that we require, including without limitation, content that we deem to be scandalous, immoral or detrimental to our image. You further agree and acknowledge that we may prohibit use of our trademarks, service marks, trade names, copyrights or any similar marks on any site or all sites, including social media websites. As used in this Franchise Agreement, the term "Website" means an interactive electronic document, contained in a network of computers linked by communications software that you operate or

authorize others to operate, and that refers to the Franchise, the Marks, us, and/or the System, and includes, without limitation, social media websites, Internet and World Wide Web home pages.

## **SBA Office of Hearings and Appeals Decision concerning Franchise Agreements:**

*CVE Appeal of The Hope Cos, LLC, SBA No. CVE-204-A (2021)*

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### **VA Office of Small and Disadvantaged Business Utilization**

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