



# 54TH ANNUAL IFA LEGAL SYMPOSIUM



**IFA**<sup>®</sup>

INTERNATIONAL FRANCHISE ASSOCIATION



# Basics Track: Registration & Disclosure

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# Outline

- Definition of a Franchise
- Purpose of Franchise Laws
- Franchise Disclosure Requirements
  - Federal and State Requirements
  - Drafting Tips
  - Timing and Delivery
- Registration Requirements
  - Registration States & Filing Requirements
  - Renewals
  - Amendments
- Exemptions from Registration & Disclosure

# Definition of a Franchise

## Elements of a Franchise Relationship:

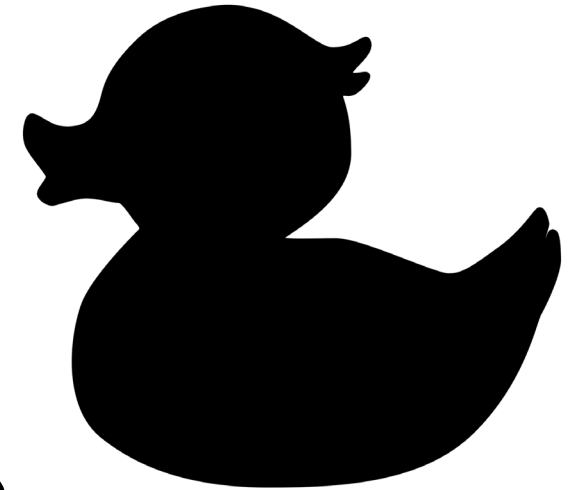
1. Trademark License
2. Franchisor has control over or provides assistance in Franchisee's method of operation
3. Required Payment (>\$615 during first six months of operation)
4. Community of Interest (state laws)
5. Marketing Plan

# Purpose of FTC's Franchise Rule

- Disclosure Mandated
  - Provide Franchisees with Sufficient Information to Make Informed Purchasing Decisions
  - “Informed investors can determine for themselves whether a particular deal is in their best interest.”
- No regulation of the business terms

# FTC Franchise Rule Scope

- Regulates Franchising in:
  - All 50 states
  - District of Columbia
  - All U.S. territories
- Anti-Waiver: If it walks and talks like a “franchise” – it’s a franchise (inadvertent franchisor)
- No Private Right of Action



# State Regulation of Franchise Sales

- Disclosure Required
- Pre-Sale Registration
  - State Review of Disclosures for Compliance
- Private Right of Action (little FTC Acts)
- Regulatory Authorities Empowered to Conduct Investigations and Assess Penalties
- NASAA Guidelines on Disclosure and Registration

# Franchise Disclosure Document

- 22 Items Disclosure describing material terms of the Franchise Relationship and a receipt
  - Material Contracts
    - Franchise Agreement
    - Development Agreement
    - Technology Agreement(s)
    - Service Agreements
  - Financial Statements
  - Lists of Current & Former Franchisees
  - Other Key Information



# Franchise Disclosure Document Delivery Timing

- 14 calendar days to review the FDD before signing or paying consideration
- Do not count the date of FDD Receipt or the date of signature
- Start counting on the day after the date listed on the FDD Receipt
- First Personal Meeting and 10 Business Day Rules
- “Reasonable request” from prospective franchisee
- 7 Calendar Day Rule for Agreement Delivery (use same counting method)

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21

# Disclosure Rules

- Prospective Franchisee: “Any person (including any agent, representative, or employee) who approaches or is approached by a franchise seller to discuss the possible establishment of a franchise relationship.”
- Copy of FDD hand delivered, faxed, emailed or otherwise delivered.
- Franchisor gives prospect directions for accessing document on the Internet.
- Paper or tangible electronic copy mailed via first class mail, deemed delivered in three business days.
- One Document Rule

# Electronic Disclosure

- Includes email, over the internet (through a franchisor's website or the website of a third-party vendor), and by CD-ROM
- Non-editable format recommended
- Advise of FDD formats before delivery (even if paper is the only option)
- Include any technological requirements to access FDD (e.g. specific browser version)

# State Disclosure Rules

- Different Timing Required in Specific States:
  - New York (unless exempt): Earlier of 10 business days or “first personal meeting”
  - Iowa: Earlier of 14 calendar days or “first personal meeting”
  - Michigan: 10 business days
  - First Personal Meeting: A face-to-face meeting between a franchisor/franchise broker and prospective franchisee to discuss sale or possible sale of a franchise.

# Franchise Disclosure Document Receipts

- Two copies of Receipts attached to FDD
- Must identify Franchise Seller (continuing obligation to update)
- Must be signed and dated by prospective franchisee (give instructions to franchisee; check dates when returned)
- Must keep receipt for at least three years (best practice is to keep for entire relationship)
- State Laws (e.g., CA) may differ

# FTC Rule FDD Requirements

- Drafting Tips and Tools
- Federal Cover Page
- Items 1-23

# Drafting Tips and Tools

- Plain English
- Addressing Specific Items
- Negative Responses
- Cross-References
- FTC Resources
- NASAA Resources

# FTC Rule Cover Page

- FTC Required Statements
- Total Investment Information
- Availability of FDD in Other Formats
- Issuance Date



# FDD Items

- Franchisor & History
- Managers
- Litigation History
- Bankruptcy of Franchisor, Managers
- Initial Fees
- On-Going Fees
- Initial Investment
- Designated Sources
- Agreement Terms
- Financing
- Franchisor Obligations
- Territorial Protection
- Trademarks
- Patents
- Franchisee Participation
- Restrictions on Franchisee
- Relationship Inflection Points
- Public Figure Involvement
- Earnings Claims/Financial Performance Representations
- Franchise Census Data
- Financial Statements
- Contract Forms
- Receipt

# FDD Item 19 – Financial Performance Representations

- FTC Rule Requirements and NASAA FPR Commentary
- Reasonable Basis at the time the FPR is made
  - No Cherry Picking
  - Time Period
  - # and % of Outlets Achieving the Stated Performance
  - Average/Median (also High/Low for Gross Sales)
  - Other Material Information
- Written Substantiation delivered upon request
- Limited Disclaimers Permitted

# State-Specific Disclosure Requirements

- Jurisdiction of State Franchise Laws
- Examples of State-Specific Disclosures
- State Cover Page/Risk Factors
- State Addenda
- State Timing Issues
- Common issues addressed in amendments:
  - Required notice and grounds for default/termination
  - Choice of Law
  - Dispute resolution: venue and jury trial
  - Statute of limitations
  - General Releases
  - Financial Assurance Conditions

# State Franchise Registration

- 14 states
- NASAA
- Filing Requirements
- Review Process/Comment Letters
- Tips for Registration Process

# Renewal and Amendment – Updates to the FDD

## Federal Requirements

- Renewal
  - 120 days after fiscal year end
- Amendment - A “Material Change” is one that has a substantial likelihood of influencing a reasonable franchisee or a reasonable prospective franchisee in making a significant decision
  - Quarterly to reflect any “material change”
  - FPRs: immediately notify prospect of change

# Renewal and Amendment – Updates to the FDD

## State Requirements

- Renewal
  - 90 to 120 days after fiscal year end
  - Prior to anniversary date
- Amendment
  - Promptly
  - Occurrence of material change
  - 30 days
  - Amended Rule

# Material Changes: Examples

- Change in management (Item 2)
- Filing of material litigation (Item 3)
- Change in any franchise or other fee (Item 5 and 6)
- Significant increase in the initial investment (Item 7)
- Change in supplier procedures (Item 8)
- Terminating, closing, failing to renew or repurchasing a significant number of franchises (Item 20)
- Significant adverse change in financial condition (Item 21)

# Exemptions

- Fractional Franchise
- Minimal Franchise Fee
- Large Franchisee
- Large Investment
- Sale to Existing Franchisee

## Follow Best Practices

- Disclose
- Wait
- Confirm elements met
- Maintain files



# Other State Filing Requirements

- Advertising
  - File in advance of use
  - Negative option review – deemed approved unless affirmatively disapproved
  - Clearance period ranges from 3 days to 7 days
  - Covers all forms of general solicitation advertising
  - Common exemptions – Internet advertising; national media or publications (>2/3 of circulation outside of the state)
- Franchise Seller / Brokers
- Franchisor's Costs and Source of Funds
- Auditor's Consent

# Liability for Violations

- Company, officer/manager, director, person of similar status, person performing similar function and/or employee who aids in violation
- Federal remedies: damages and attorneys' fees, cease and desist orders, civil penalties of up to \$46,517 per violation, required franchise compliance training, rescission of franchise agreements, temporary restraining order, preliminary and/or permanent injunctions, and/or negative FDD disclosures
- State remedies: civil liability – private right of action, criminal liability – misdemeanors and felonies for willful violations and fraud, damages and attorneys' fees, cease and desist orders, temporary restraining order, preliminary and/or permanent injunctions, restitution, rescission, civil fines ranging from \$100 to \$100,000 per violation, and/or negative FDD disclosures

# Questions?

Thank you!