



IFA LEGAL SYMPOSIUM

Basics Track: Registration & Disclosure

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Speakers

- **Christine Johnson:** Christine Johnson serves as Chief Administrative Officer and General Counsel for Le Duff America. She oversees all human resources and legal matters for the company and its affiliates, which operate food manufacturing facilities and several restaurant concepts globally, including the La Madeleine and Brioche Doree brands.
- **Kyle Lennox:** Kyle is an attorney with Greenberg Traurig, LLP who focuses his practice on franchising, licensing, distribution, and general corporate matters. He helps clients structure their franchise programs to meet their short and long-term goals and assists clients with purchasing and selling franchise systems through mergers and acquisitions. Kyle maintains a particular focus in international transactions and regularly helps clients expand their brands to various international markets.

Objectives of Session

- Overview of Federal & State Regulations
- Information to be Included in FDD
- Timing and Delivery Requirements of the FDD
- States that Require Registration of the FDD
- Federal and State Exemptions
- When to Amend the FDD
- Liability and Penalties for Violating Franchise Laws

What is a Franchise?

Federal Trade Commission Definition

- Business associated with a **trademark**
- Franchisor exerts (or has the authority to exert) a significant degree of **control over the franchisee's operation** or provides **significant assistance** in the franchisee's method of operation
- Franchisee makes (or commits to make) a “**required payment**”

Three Bodies of Franchise Law

- Federal and state registration/disclosure statutes and regulations governing the offer and sale of franchises
- Federal and state business opportunity laws governing marketing plans without a trademark at their core
- State ‘relationship’ laws governing the post-sale relationship

FTC Franchise Rule

- Created in 1979
- Applies to all transactions in the United States
 - Cannot be waived
 - No private right of action
 - Created FTC format disclosure document
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 - Cannot be waived
 - No private right of action
 - Created FTC format disclosure document
- Disclosure only – No registration required

FTC Franchise Rule (cont'd)

- No Pre-sale Registration Required
- FDD Must Be Provided to Prospective Franchisee
- No Regulation of the Franchisor-Franchisee Relationship
- Electronic Disclosure Permitted
- Use of “Plain English” Mandated
- Clear FDD Delivery Requirements
- Numerous Exemptions Available

Applicability of State Franchise Laws

- Scope of Coverage - What is a franchise?
 - Marketing plan or
 - Community of Interest
- Does the state law apply? (where offered, where accepted, franchisee's residence and location of business)
- Can we test the water before we dive in?
- Does the state provide an exemption/exclusion for the franchisor, the franchisee or the transaction?
- When can we make an offer? A sale?

What is in an FDD?

- 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

Important Disclosure Items

- Item 1 – Franchisor, its Parents, its Affiliates and the Franchise
- Item 3 – Disclose current and prior actions and litigation
- Items 5 – 7 – Fees
- Item 8 – Supplier Information, Revenue and Rebates
- Item 11 – Franchisor Obligations
- Item 12 - Territory
- Item 19 – Financial Performance Representations
- Item 20 – Franchise Unit Counts
- Item 23 – Receipts

Item 19 – Financial Performance Representations

- FTC Rule Definition – [A]ny representation, including any oral, written, or visual representation, to a prospective franchisee, including a representation in the general media, that states, expressly or by implication, **a specific level or range of actual or potential sales, income, gross profits, or net profits.....**
- Examples – COGS, ROI, Pro formas
- Must have a reasonable basis for making the claim at the time that it is made

FDD Retention

- Under Section 436.6(h), franchisors must retain each form of the **FDD** for the past **3 years**
- The franchisor must retain a copy of the **signed receipt** for the Disclosure Document for at least **3 years**
- It is a best practice to keep the receipt together with the original franchise agreement in the files of the franchisor for the life of the franchise
 - Statute of limitations is typically 6 years
- Since the FTC Rule does not specify how these records must be kept, they may be kept in the format preferred by the franchisor, whether electronic or paper

Item 23 Receipts

- 2 Copies of Receipts attached to FDD
- Must identify Franchise Seller (Continuing Obligation to Update)
- Must be signed and dated by prospective franchise (give instructions to franchisee; check dates when returned)
- Must keep receipt for at least 3 years (best practice is to keep for entire relationship)
- California – Required to Maintain in perpetuity

FTC Franchise Rule – FDD Delivery

- FTC Rule – 14+ Calendar Days
- State Laws May Differ
- 7 Calendar Day Rule
 - If Franchisor makes unilateral/material changes to agreements, execution ready versions must be furnished at least 7 calendar days before execution
 - Changes made at prospect's request do not trigger 7-day rule.
 - Filling in blanks does not trigger 7-day rule (except Development Schedule)
- 14 Day Rule and 7 Day Rule can run concurrently

Counting Days

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

The table illustrates a 21-day period. The days of the week are labeled at the top. The days are numbered 1 through 21. A hand holding a pen is shown writing on a document on Monday (day 2), which is circled in red. A hand holding a pen is shown writing on a document on Tuesday (day 17), which is circled in blue. All days from 3 to 21 have a checkmark next to the number.

Electronic Disclosure under FTC Rule

- Electronic version permitted if one document
- Receipt may be linked or embedded, but not separate
- No extraneous materials
- Before furnishing franchisor must tell the prospective franchisee about available formats
- The disclosures must be in a form that permits each prospective franchisee to store, download, print, or otherwise maintain the document for future reference

Does Everyone Receive the Same FDD?

- Multi-State Disclosure Document
 - One main FDD used to comply with FTC Rule and state franchise laws
 - Exhibit of State-Specific Disclosures and Agreement Riders
 - State-Specific Effective Dates
- State law changes (State Addenda)
- State-specific FDDs

Registration and Disclosure States

California

Hawaii

Indiana

Illinois

Maryland

Michigan

Minnesota

New York

North Dakota

Rhode Island

South Dakota

Virginia

Washington

Wisconsin

Beware of Business Opportunity States

Annual Filings – Florida, Utah

One-Time Filings – Connecticut, Kentucky,
Nebraska, Texas

State Registrations (cont'd)

- How do you get registered?
- A review of the Registration Process
- Registration of Franchise Brokers
- Registration of Franchise Salespersons
- Franchise Advertising

Federal Exemptions

- Fractional Franchises
- Payment of Fees less than \$615
- Sophisticated Investor Exemptions
- Large Investment
- Large Franchisee (in business for 5+ years and net worth of at least \$6,165,500)
- Insiders

State Exemptions - Franchisor

- Audited net worth of franchisor or parent as of last fiscal year end meets specific level
- Experience of at least 5 years operating or franchising
- Minimum number of units (usually 25) owned or franchised for experience period
- Available in California, Illinois, Indiana, Maryland, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington
- Deliver disclosure document (state laws vary)
- File notice with state and pay fee annually

State Exemptions - Franchisee

- High net worth or high-income individuals
- Franchisor insider
- Financial institutions
- Experience with investments
- Notice required for each transaction
- Available in California, Illinois, Maryland, Rhode Island, Washington, Wisconsin

Amending the FDD – Material Change

- 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
- Material changes require an amendment to the FDD and filing with registration states
- Automatically effective or no filing in IL, IN, MI, SD, VA, WI
- Under FTC Rule, can be done by supplemental disclosure within reasonable time after fiscal year quarter ends (but state laws may require different procedure)

Examples of Material Change

- 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)

Examples of Federal Remedies

- The following may apply for violation of FTC Franchise Rule:
 - Damages and attorneys' fees
 - Cease and desist orders
 - Civil penalties of up to \$40,000 per violation
 - Required franchise compliance training
 - Rescission of franchise agreements
 - Temporary restraining order
 - Preliminary and/or permanent injunctions
 - Negative FDD Disclosures

Examples of State Remedies

- The following may apply for violations of state franchise laws:
 - Civil liability – private right of action
 - Criminal liability – misdemeanors and felonies for willful violations and fraud
 - Damages and attorneys' fees
 - Cease and desist orders
 - Preliminary and/or permanent injunctions
 - Restitution
 - Rescission
 - Civil fines ranging from \$100 to \$100,000 per violation
 - Negative FDD Disclosures