Franchise Sales and Disclosure Law

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Franchise Compliance Training

Agenda

• Overview of U. S. Regulation
• Federal Regulation
• State Regulation
• Disclosure Documents
• Financial Performance Representations
• Franchise Recruitment Advertising Rules & Prohibitions
• Compliance Program, Record Keeping and Documentation
• Administrative, Civil and Criminal Penalties for Violations
The Three Bodies of Franchise Law

- Federal and state registration / disclosure statutes and regulations govern the offer and sale of franchises

- State ‘relationship’ laws govern the post-sale relationship and franchise contract issues

- Federal and state business opportunity laws require exemption perfection or cover franchises without registered marks
Federal And State Franchise Registration/Disclosure Laws

- **State Approaches:**
  - California Franchise Investment Law - 1971
  - Midwest Securities Commissioners Assn. adopted first franchise offering circular format in 1974;
  - NASAA format disclosure documents adopted in 1986 and 1993; 2008 revisions in progress
  - Merit review of disclosure content and offering terms
  - Annual Notice Filing
  - Single Notice Filing

- **FTC Franchise Rule** - since 1978
  - NO REGISTRATION REQUIRED – Not equivalent of Securities Acts
  - Governs selling process and content of disclosure, not substance of offering
  - Creates disclosure regimen and specifies disclosure document
Registration States in Red
Pre-sale Merit Review
Do Not Offer Or Sell Unless Registered Or Exempt
Pre-Sale Notice Registration - Do Not Offer Or Sell Until Notice Filed

Annual:

One time:

(Marks newer than 10/1/96)*

*Business Opportunity Law, not Franchise Law, Filing

49TH ANNUAL CONVENTION
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## Franchise Relationship Law States

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*Venue only*
Business Opportunity Laws

- Alabama
- Alaska
- California
- Connecticut
- Florida
- Georgia
- Illinois
- Indiana
- Iowa
- Kentucky
- Louisiana
- Maine
- Maryland
- Michigan
- Minnesota
- Nebraska
- New Hampshire
- N. Carolina
- Ohio
- Oklahoma
- S. Carolina
- S. Dakota
- Texas
- Utah
- Virginia
- Washington
- FTC Bus. Opp. Rule
Federal Trade Commission Rule

Applies to All Franchise Transactions in the United States
- In effect since 1979
- Cannot be waived
- Created FTC format disclosure document
- Amended January 2007, mandatory July 1, 2008;
- No private right of action
- State “Little FTC Act” and common law fraud offer private remedies if disclosure violated
Exemptions under the Revised Rule

– Large Franchisees—Must have been in business at least 5 years and have a net worth of at least $5 million

– Large Initial Investment—Individual initial investment of at least $1 million
  • Excludes financing received from franchisor and the cost of unimproved land

– Related party--applies if owner(s) having controlling ownership in franchise business have at least 2 years experience with the franchisor as an officer, owner or manager
2007 Franchise Rule

- 10 business days becomes 14 calendar days
- 5 business days becomes 7 calendar days
- Simple completion of transaction information – name, address, location – “non-substantive, fill in the blank” avoids second waiting period
- Franchisor completion of material terms triggers 7 calendar day waiting period
- Franchisee negotiation of standard terms does not trigger 7 calendar day waiting period
Counting the Days

- Date of delivery does not count
- What about the anxious/sophisticated franchisee?
- **Revised Rule** – 14 calendar days; can sign on 15th day after delivery
- **Revised Rule** – If 7 calendar day waiting period applies; can sign on 8th day after delivery of definitive agreements if materially changed by franchisor from forms in FDD
First Personal Meeting – Transition Issues

- Eliminated in Revised Rule

- Remains applicable under certain state disclosure and business opportunity laws and regulations, state large franchisor exemptions:
  - Illinois
  - Iowa
  - Maryland
  - New York
  - Oklahoma
  - Rhode Island
First Personal Meeting

- "Personal meeting" means a face-to-face meeting between a franchisor or franchise broker (or any agent, representative, or employee thereof) and a prospective franchisee which is held for the purpose of discussing the sale or possible sale of a franchise.
- Doesn’t include electronic or voice communications that are not direct, in-person meetings
- If you discuss specific territories or fees, it’s a personal meeting
- Casual meet & greet at a trade show isn’t a personal meeting
- The sit-down rule
Who Discloses?

- **Revised Rule** – franchisor responsible; franchise broker concept eliminated
  - No Items 2, 3, 4 disclosure
  - States franchise broker disclosure on state cover page and in addenda; risk factor added
  - Franchise broker replaced by franchise seller concept relevant for Item 23 receipt and prohibitions
Who is A Franchise Seller?

- Anyone that offers for sale, sells, or arranges for the sale of a franchise
- These include the franchisor, its employees, representatives, agents, sub-franchisors and third party brokers who are involved in franchise sales activities are included
- Existing franchisees selling their own units—and are not selling on behalf of franchisor—are not included in this definition
Recognized Delivery Means

- Franchisor deemed to furnish disclosure document by required date if:
  - 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 3 business days
E Disclosure & Receipt

- System records prospective franchisee’s receipt
- External web page accessible only from Item 23 receipt page acceptable
- No additional contents or links permitted
- Signature can be by use of security code, password, or electronic signature
- Icon to print only receipt for manual signature and return permitted
- Separate receipt page prohibited
Electronic Disclosure Document

- Electronic version permitted if one document
- Receipt may be linked or embedded, but not separate
- No fun stuff
- 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.
Updates for Material Changes

• Quarterly by supplement – BEWARE THE STATES, HOWEVER!
• Annual update includes Q1 of new fiscal year
• Before signing agreement, deliver supplement to each prospect who reasonably requests updates – Creates tracking obligation
• Notify of material changes in Item 19
• Unaudited financials identified
What’s a Material Change?

- The terms "material," "material fact," and "material change" shall include any fact, circumstance, or set of conditions which has a **substantial likelihood of influencing** a reasonable franchisee or a **reasonable prospective franchisee** in the making of a significant decision relating to a named franchise business or which has **any significant financial impact** on a franchisee or prospective franchisee.
Disclosure Document

- Merit review state rules demand immediate amendments for material changes and do not yet recognize supplements
- Must also amend annually within 120 days after end of fiscal year for latest annual audited financial statements and update Item 20
- Good news later, bad news now.
- Stop selling until amendments completed, then redisclose (if material adverse changes) and restart 14 day waiting period
Franchise Disclosure Law

- Acknowledgment of Receipt - last page of FDD
  - Prospective Franchisee signs and dates both copies in back of FDD
  - Put one original in file
  - Sender keeps own copy
- Guilty until proven innocent
- **Revised Rule** – identifies specific franchise seller and contact info for each transaction
- Must be updated for franchise seller designations
Franchise Seller on Receipt

- **Revised Rule** – identifies specific franchise seller and contact info for each transaction at some point:
  - Instruct franchisee on the receipt page to write in the name of the franchise seller before signing and returning the receipt page to the franchisor.
  - Franchisor could: (1) attach to the previously signed receipt a statement, business card, or other document showing contact info of the seller; and (2) send a copy of the attachment to the prospective franchisee so that the prospective franchisee has a copy of the completed receipt.
  - Both the franchisor and prospective franchisee must each have a copy of the same receipt.
Dealing with the States

- The Revised FTC Rule continues the policy of limited federal preemption and concurrent state regulation
- Merit Review states can continue to regulate in this area, but only if their laws offer equal or greater protection, such as more extensive disclosure requirements
- NASAA has published 2008 FRANCHISE REGISTRATION AND DISCLOSURE GUIDELINES
- Preliminary Commentary published: http://www.nasaa.org/issues_answers/regulatory_activity/9328.cfm
- New forms for ancillary documents
State Franchise Registration/Disclosure Laws

- Disclosure trigger – the “offer”
- Jurisdictional coverage – which state laws may apply?
- Be wary of meetings and shows

The Key Questions:

- What is an offer?
- Where is the offer directed from?
- Where is the offer directed to?
- Where is the offer accepted?
- Where is the franchisee’s domicile or residence?
- Where will the unit be located?
Offers Unlawful Unless Registered in Merit Review States

• **California**: it shall be unlawful for any person to offer or sell any franchise in this state unless the offer of the franchise has been registered (FIL §311110)

• **Illinois**: It is unlawful for any person to offer or sell any franchise required to be registered under this Act unless the franchise has been registered under this Act or is exempt (FDA §705/5)

• **New York**: It shall be unlawful and prohibited for any person to offer to sell or sell in this state any franchise unless and until there shall have been registered with the department of law prior to such offer or sale, a written statement to be known as an "offering prospectus" (GBL§683)
What is an offer to sell?

California:

- "Sale" or "sell" includes every contract or agreement of sale of, contract to sell, or disposition of, a franchise or interest in a franchise for value.
- "Offer" or "offer to sell" includes **every attempt to offer to dispose of, or solicitation of an offer to buy**, a franchise or interest in a franchise for value.
- An offer or sale of a franchise is made in this state when an offer to sell is made in this state, or an offer to buy is accepted in this state, or, if the franchisee is domiciled in this state, the franchised business is or will be operated in this state.

**BUT:**

- Transaction with a resident of another state or any territory or foreign country, shall be exempt if all locations of franchised business are physically located outside this state.
What is an offer to sell?

New York:

- "Offer" or "offer to sell" includes any attempt to offer to dispose of, or solicitation of an offer to buy, a franchise or interest in a franchise for value.
- An offer or sale of a franchise is made in this state when an offer to sell is made in this state, or an offer to buy is accepted in this state, or, if the franchisee is domiciled in this state, the franchised business is or will be operated in this state.
- An offer to sell is made in this state when the offer either originated from this state or is directed by the offeror to this state and received at the place to which it is directed. An offer to sell is accepted in this state when acceptance is communicated to the offeror from this state.
What is not an offer to sell?

**Illinois:**
- National media advertising
- the offer or sale of a franchise by a franchisee for its own account if the sale is not effected by or through a franchisor. A sale is not effected by or through a franchisor merely because a franchisor has a right to approve or disapprove a different franchisee or requires payment of a reasonable transfer fee.
- the extension or renewal of an existing franchise or the exchange or substitution of a modified or amended franchise agreement where there is no interruption in the operation of the franchise business by the franchisee.
State Disclosure Laws – Presale Waiting Period

- Registration states have set their own waiting periods
- California, Illinois, South Dakota now 14 calendar days
- Other states vary between 72 hours and 10 business days

**Revised Rule:** Waiting period is longer of 14 calendar days or 10 business days in Iowa, Maryland, Michigan, New York, Oklahoma, Rhode Island, Washington, Wisconsin
State Exemptions

- Similar to securities laws, there are:
  - Exempt Franchisors
  - Exempt Franchisees
  - Exempt transactions
  - Discretionary Exemptions
- Exemption from registration only, not civil and criminal remedies
- CA – exemption from negotiated change supplement to FDD required under Corp. Code 31109.1
Exempt Franchisors

- Large Experienced Companies
- Available in California, Illinois, Indiana, Maryland, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington
- Deliver disclosure document
- **Revised Rule**: Deliver disclosure document in California, Maryland, Rhode Island, Virginia, Washington using longer of 14 days or 10 business days for waiting period
- File notice with State and pay fee annually
- Consent to service of process
- Burden of proof on franchisor to prove qualification
Exempt Franchisees

- High net worth or high income individuals
  - Franchisor insider
- Financial institutions
- Experience with investments
- Notice required for each transaction
- Disclosure document delivered
- No plan of resale or distribution
- Burden of proof on franchisor
- Available in California, Illinois, Maryland, Rhode Island, Washington, Wisconsin
Exempt Transactions

• Sale to existing franchisee under previously disclosed form of franchise agreement and no material changes in contract terms
• Renewal or extension of existing franchise if no material changes in contract terms
• Sale by franchisee for own account, no proceeds to franchisor, whose role is limited to approval of transferee
State Franchise Registration/Disclosure Laws

- Franchisor capitalization requirements
  - Financial Statements reviewed
  - Supplemental Information Page sources of funds for pre-opening services reviewed
  - FAS 45 causes delayed recognition of revenue until substantially all services provided, causes negative working capital when expenses incurred prior to recognition
  - Low capital means impound/escrow, surety bond or fee deferral
What’s in a FDD – 22 Nuggets and a Receipt

- 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
State Franchise Registration/ Disclosure Laws

- **Registration Process**
  - Fee

- Wait until clearance issued to sell and close transactions

- Registration is effective either for a one year period (Illinois, Indiana, Maryland, Michigan, North Dakota, Virginia, Washington, Wisconsin), or until 90, 110 or 120 days (California, Hawaii, Minnesota, New York, Rhode Island, South Dakota) after the end of the franchisor’s fiscal year
Franchise Seller Disclosure

- All persons who solicit, offer and sell franchises complete state information forms
- Franchise brokers (non-employee sales people), Franchisor employees, officers
- Not finders who merely introduce
- Area Representatives are brokers/agents
- NASAA guidelines require continuous updating of franchise seller disclosure forms
Earnings Claims/ Financial Performance Representations

1979 Rule:
• Information given to a prospective franchisee by, on behalf of or at the direction of the franchisor or its agent, from which a specific level or range of actual or potential sales, costs, income or profit from franchised or non-franchised units may be easily ascertained.

Revised Rule:
• 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.
Earnings Claims/ FPR’s

- **Revised Rule:** The term includes a chart, table, or mathematical calculation that shows possible results based on a combination of variables.
Required Negative Disclosure

- Required if FDD does not include a financial performance representation; cannot be modified

“We do not make any representations about a franchisee’s future financial performance or the past financial performance of company-owned or franchised outlets. We also do not authorize our employees or representatives to make any such representations either orally or in writing. If you are purchasing an existing outlet, however, we may provide you with the actual records of that outlet. If you receive any other financial performance information or projections of your future income, you should report it to the franchisor’s management by contacting [name, address and telephone number], the Federal Trade Commission, and the appropriate state regulatory agencies.”
Supplemental Financial Performance Representation

• Item 19 financial performance in FDD
• directed to a particular location or circumstance
• must be in writing
• explain the departure from the Item 19 info in FDD,
• be prepared in accordance with item 19,
• be furnished to the prospective franchisee.
A franchisor electing to make a financial performance representation must, among other things, have a reasonable basis and written substantiation for the representation at the time it is made, and disclose the bases and assumptions underlying the representation in Item 19. The Item 19 disclosures also must include an admonition that a prospective franchisee's actual earnings may differ.
Compliance Guide

- Financial performance information that differs from that included in Item 19 may be given only if:
  1. a franchisor provides the actual records of an existing outlet you are considering buying; or
  2. a franchisor supplements the information provided in this Item 19, for example, by providing information about possible performance at a particular location or under particular circumstances.
Compliance Guide

• The factual information must be the sort of information upon which a prudent businessperson would rely in making an investment decision.
• The quality and quantity of information constituting a reasonable basis may vary from case to case.
• The type of information needed to support and substantiate a financial performance representation will also vary, depending on whether the representation is a projection or a historic report of actual performance.
Compliance Guide

• Example: a representation that franchisees earn a net profit of $30,000 per year implies that is the typical experience of the system's franchisees.

  – The representation would not have a reasonable basis if:
    • only a small minority of the franchisees earn this amount,
    • profits were due to unusual or non-recurring conditions, or
    • franchisees used inconsistent methods for determining and reporting their profits.
Compliance Guide

• Historic Performance

A franchisor making an historic financial performance representation must state the material facts underlying the representation. Item 19 of the FTC amended Rule specifies six separate elements comprising the material bases for such a representation, each of which must be expressly addressed.
Compliance Guide

1. The Group Measured -
   • *Did All Outlets in the System, or Only Some of Them, Achieve the Stated Level of Performance?*
Compliance Guide

3. Time Period Measured -

When Was the Stated Level of Performance Achieved?
4. Number of Outlets Reporting - How Many Outlets in the Relevant Group Supplied the Performance Data Underlying the Representation?
5. **Number and Percentage of Outlets that Achieved the Stated Level of Performance - What Proportion of the Group Measured Achieved the Results Claimed?**

- Franchisors must disclose both the number and percentage of the outlets that provided data that actually attained or surpassed the stated results.
6. Distinguishing Characteristics - What Are the Common Attributes of the Outlets That Achieved the Stated Level of Performance?

• Implicit assumption underlying any historic performance representation:

  A prospective franchisee may achieve at least the same level of performance - although, of course, there is no guarantee that this will happen.

• Factors tending to call that implicit assumption into question must be disclosed.
Compliance Guide

Subgroup Disclosure:

• Item 19 must disclose any characteristic of the group or subgroup on which the claim is based that might set that group apart from outlets currently being offered for sale.
• Admonition

The amended Rule's Item 19 requires a clear and conspicuous admonition that *a new franchisee's individual financial results may differ from the results stated in the Item 19 disclosure.*
Compliance Guide

• **Availability of Substantiation**

If a financial performance representation is in Item 19, then it must also include a statement that written substantiation for the representation will be made available to the prospective franchisee upon reasonable request.

• “Reasonable" pertains to time and location.
Compliance Guide

• **Material Changes Relating to Financial Performance Representations**

• At the time of furnishing a disclosure document, any franchise seller (including any broker) must notify a prospective franchisee if the seller knows of any material changes relating to a financial performance representation.

• This obligation arises even if a disclosure document is furnished at a time that falls between quarterly updates.
Compliance Guide

• If the broker knows of a material change in information underlying the Item 19 representation - such as new survey results that cast doubt on the accuracy of the Item 19 financial performance representation - the broker must notify the prospective franchisee of that fact when furnishing the disclosure document.

• “Notify” does not mean furnishing an updated disclosure document all over again. A seller may inform the prospective franchisee of the material change underlying the Item 19 in any reasonable manner, such as by letter, telephone call, or email.

• The franchise seller has the burden of proving that such notification was made.
Compliance Guide

• Nevertheless, any seller can be held liable for the seller's own violation of the amended Rule's provisions that prohibit:
  – making any financial performance representations unless the franchise seller has a reasonable basis and written substantiation for the representation at the time the representation is made;
  – failing to include in any financial performance representation a clear and conspicuous admonition that a new franchisee's individual financial results may differ from the results stated in the financial performance representation; or
  – making any financial performance representation that is not included in Item 19 of the franchisor's disclosure document.
Cost information no longer considered an “earnings claim”

- Free to discuss cost only information
- Costs should be discussed in dollars
  - Not as a percentage of gross sales
  - Percentage of gross sales information would constitute a financial performance representation
- Registration states may still have problems with discussing “cost only” information
Compliance Guide

• General Media Representations

Financial performance representations include statements made in the general media, where they are likely to attract members of the public interested in purchasing a franchise.

• “General media" includes all forms of print, broadcast and electronic advertising, including radio, television, magazines, newspapers, and billboards; plus electronic advertisements placed on a franchisor's website or on a web site operated by a third party. Electronic advertisements include both static and dynamic advertisements, like pop-up screen and banner advertisements.
Compliance Guide

• Unsolicited bulk email sent to the public - "spam" - is also a form of general media advertising.
• A financial performance message contained in the ad constitutes a general media claim and triggers the Rule's disclosure and substantiation requirements.
Compliance Guide

• What about Statements in SEC filings - Do They Constitute General Media Representations?

Publicly filed financial performance information submitted to the Securities and Exchange Commission (e.g., 10-Qs and 10-Ks) are not considered general media representations.

• FTC historical policy excludes from general media representations any communications to financial journals or the trade press undertaken in connection with bona fide news stories.

• Financial performance information provided directly to lenders in connection with arranging financing for prospective franchisees also does not constitute a general media representation.
Compliance Guide

• Specific Requirements Applicable to General Media Claims
  • Truthful and reasonable
  • Backed by substantiating written information
  • General media financial performance representations must state:
    – the number and percentage of outlets from which supporting data for the representation were gathered that actually attained or surpassed the represented level of financial performance;
    – the time period when the performance results were achieved; and
    – a clear and conspicuous admonition that a new franchisee's results may differ from the represented performance.
Compliance Guide

• Relationship Between General Media Financial Performance Representations and Item 19 Disclosures

• A franchise seller making a financial performance representation in the general media must ensure that a full disclosure of the financial performance representation - including the material bases and assumptions - appears in Item 19 of the franchisor's disclosure document.

• A franchisor running an advertisement containing financial performance information at the very least must furnish any prospective franchisees with the required Item 19 disclosures while the advertisement is running.

• If a franchisor stops running the advertisement and makes no additional financial performance representations in the general media, it nonetheless must continue to disclose information required by Item 19 for a reasonable period of time thereafter. A reasonable period of time is not less than six months.
Compliance Guide

• If a franchisor replaces one advertisement containing a financial performance representation with a new one containing updated financial information, the updated information - not the information used in the initial version of the advertisement – must be included in the franchisor's Item 19 disclosures.

• Updated information is clearly more material to a prospective franchisee than older, perhaps stale, and possibly misleading information.

• Where a franchisor runs multiple advertisements containing different types of financial performance claims, the franchisor must disclose and provide information for each type of claim in Item 19 of its disclosure document.
PROHIBITIONS:

• Franchise Sellers are prohibited from making financial performance representations that are not true or are not substantiated at the time they are made.

“Franchise seller” is: A person that offers for sale, sells, or arranges for the sale of a franchise. It includes the franchisor and the franchisor’s employees, representatives, agents, subfranchisors, and third-party brokers who are involved in franchise sales activities.

Franchise seller does not include existing franchisees who sell only their own outlet and who are otherwise not engaged in franchise sales on behalf of the franchisor.
Compliance Guide

• Inclusion of Financial Performance Information in Item 19

All financial performance representations must appear in Item 19 of the disclosure document.

• A franchise seller violates the FTC Rule if it makes a financial performance representation not made in Item 19 that is inconsistent with what appears in Item 19.

• A franchisor cannot provide or authorize others to provide prospective franchisees with financial performance information while at the same time stating in Item 19 that the franchisor does not authorize the making of any financial performance representations.
Compliance Guide

• Prohibition Against Contradictory Information

The Rule prohibits a franchise seller from making any statement that contradicts the information disclosed in the franchisor's disclosure document.

• This prohibition is necessary to prevent deception and to preserve the integrity of the disclosure document.

• Prohibited contradictory statements include those made orally, visually, or in writing.

• Example: a franchise broker would violate the Rule if it stated that the franchisor has never been sued by a franchisee if the franchisor has been sued and has disclosed that information in Item 3.

• Franchise sellers are always free to disseminate additional truthful non-contradictory information to a prospective franchisee, especially if required to do so by state law or at the written request of state franchise examiners.
Franchise Recruitment 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
- Does not cover specific communications directed at individuals that are not part of campaign or similar activity
- Prohibited – “success” or “profits”
State Franchise Registration/Disclosure Laws

- 7 States with advance filing requirements for franchise advertising:
  - California
  - Maryland
  - Minnesota
  - New York
  - North Dakota
  - Rhode Island
  - Washington
Federal and State Franchise Registration/ Disclosure Laws

Permitted and prohibited negotiations with prospective franchisees
Franchise Relationship Laws

- Create Good Cause requirement for termination, renewal; may limit expansion, require local venue
- Grant franchisee rights that interfere with business decisions
- See State Addenda for references
- Expanded by state regulation and administrative policy in certain states – Dakotas & Minnesota
- Beware Iowa, Puerto Rico, Rhode Island & New Jersey – difficult to terminate or expire without renewal
Prohibitions Under Revised Rule

- Failing to furnish an FDD earlier than the established time frames upon the reasonable request of a prospective franchisee
- Failing to provide a prospective franchisee who already has received an FDD with a copy of the most recent FDD and any quarterly updates upon reasonable request (before signing the franchise agreement)
- Making financial representations without a reasonable basis and written substantiation, and includes the information in Item 19
- Failing to provide a prospective franchisee with written substantiation of the financial representation in Item 19, upon reasonable request
Prohibitions Under Revised Rule – 436.9

- Making a claim or representation that contradicts the information required to be disclosed
- Misrepresenting that any person purchased or operated a franchise or can furnish independent and reliable information on current or former franchisees’ experiences (bans use of shills)
- Presenting a prospective franchisee with an agreement containing unilateral changes from FDD, less than 7 days before signing
- Failing to refund deposits or fees identified as refundable in the FDD
- Requiring a franchise to waive reliance on any representation made in the FDD
Record Keeping

• Goals:
  – Practice and demonstrate compliance in ordinary course of business
  – Prove compliance to auditors, litigators and regulators
  – Avoid rescission claims
  – Avoid management controls/risk assessment issues
• Key Dates & Actions: Track Deal Flow & Steps
  – What was done and when?
  – Who was involved?
  – What was delivered/received?
  – Who and what was checked, and when?
  – Were incipient violations found and corrected before the sale closed?
Sales Practice Training and Documentation

- Selling franchises is a regulated activity
- Monitor State registration status (red, yellow, green)
- Key points:
  - Process – waiting periods
  - Practices – advertising clearance and prohibitions
  - Substance – disclosure document and approved collateral material
  - Financial Performance Representations – what not to say or comment upon
  - Records – Acknowledgement of Receipt, FDD
- Repetition and rosters
- Avoid the untruths
Federal Remedies

- Evaluate under **Franchise Rule Enforcement Protocol; 16 CFR 14.17; effective December 21, 1984; 49 Federal Register 50632, December 31, 1984**
- No private right of action
- Violation to fail to return refundable fees
- FTC has a number of remedies
  - Civil investigation
    - Subpoena documents and witnesses
  - Cease and Desist Orders
  - Temporary and Permanent Injunctions
  - Civil Fines up to $11,000 per violation
  - Refer Crimes to Justice Department
  - Order Restitution
  - Order referral to IFA Compliance Training Program
State Remedies

- Stop Order – cease selling
- Administrative Investigation – subpoena power
  - assurance of discontinuance; reimbursement of investigation costs
- Civil Remedies – cessation of violation; penalties up to $50,000 per violation
- Criminal Prosecution – misdemeanors and felonies
- Control person liability
- Private Rights of action
  - Strict liability – no causation
  - Right of rescission
  - Civil damages
  - Get out of jail free card
Franchise Sales And Disclosure Law Compliance Training

- Conclusion
- What questions do you have?

It's QUESTION TIME!!