

2018 IFA

LEGAL SYMPOSIUM

• May 6-8 | Washington, DC

Basics Track: Registration & Disclosure

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Agenda

- Definition of a Franchise
- History and 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

3 Elements of a Franchise Relationship:

Trademark License

Promise of Substantial Assistance or Right to Control

Fee in Excess of \$570 during the first six months of operation

1. Trademark License
2. Seller Provides Significant Assistance or Seller has Right to Control Franchisee's Method of Operation
3. Fee (>\$570 During First Six Months of Operation)

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History and Purpose of FTC's Franchise Rule

- Advent of Franchise Regulations in the 1970s
- FTC Adopts Franchise Rule in 1979
- FTC's Disclosure Mandate
 - 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.”
- FTC Adopts Amended Franchise Rule in 2007

FTC Rule Scope

- Regulates Franchising at Federal Level
- 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
- No Private Right of Action

State Regulation of Franchise Sales

- Disclosure Required (State-Specific Disclosures Often Required)
- Pre-Sale Registration of Franchise Offering
 - Enables State Regulators to Review Disclosures for Compliance
- Private Right of Action
- Regulatory Authorities Empowered to Conduct Investigations
- NASAA Guidelines on Disclosure and Registration

The FDD

- 23 Item Disclosure describing material terms of the Franchise Relationship
 - Material Contracts
 - Franchise Agreement
 - Technology Agreement(s)
 - Guaranty
 - Service Agreements
 - Financial Statements
 - Lists of Current & Former Franchisees
 - Other Key Information

Timing for Delivery

- Must have a full 14 calendar days to review the FDD before signing or paying consideration
- Do not count the date of FDD Receipt
- Start counting on the day after the date listed on the FDD Receipt
- Be cognizant of State First Personal Meeting and 10 Business Day Rules
- 7 Calendar Day Rule for Agreement Delivery

May 2018						
FDD DELIVERY CALENDAR						
Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
		1	2	3	4	5
			DELIVERY DATE	→		
6	7	8	9	10	11	12
→						
13	14	15	16	17	18	19
→				SIGN DATE!		
20	21	22	23	24	25	26
27	28	29	30	31		

Disclosure

- 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.”
- Disclose FDD upon “reasonable request” from prospective franchisees
- One Document Rule

State Disclosure

- Different Timing Required in Specific States:
 - NY: 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.

E- Disclosure

- Delivery Format and E-Disclosure
 - Electronic disclosure includes disclosure by 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)

Disclosure Rules of the Road



Complete FDD in .PDF Format or Hard Copy



Complete FDD with Print Toggle on Receipts



Complete FDD with Print Toggle on FDD Cover Page



CD-ROM Containing FDD with Hard Copy Printed Receipts



CD-ROM or Email Containing FDD Booklet and Separate .PDF Receipts



Audio, Video, or other Multi-Media

Federal FDD Requirements

- Drafting Tips and Tools
- Federal Cover Page
- Items 1-12 (John)
- Items 13-23 (Janaki)

Drafting Tips and Tools

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

Federal Cover Page

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

FDD Items 1-4

- Item 1 – Franchisor/Patents/Predecessors/Affiliates
- Item 2 – Business Experience
- Item 3 – Litigation
- Item 4 – Bankruptcy

FDD Items 5-8

- Item 5 – Initial Fee
- Item 6 – Other Fees
- Item 7 – Estimated Initial Investment
- Item 8 – Restrictions on Sources of Products and Services

FDD Items 9-12

- Item 9 – Franchisee’s Obligations
- Item 10 – Financing
- Item 11 – Franchisor’s Assistance, Advertising, Computer Systems and Training
- Item 12 – Territory

FDD Items 13- 16

- Item 13 – Trademarks
- Item 14 – Patents, Copyrights, and Proprietary Information
- Item 15 – Obligation to Participate in the Actual Operation of the Franchised Business
- Item 16 – Restrictions on What the Franchisee May Sell

FDD Items 17 & 18

- Item 17 – Renewal, Termination, Transfer, and Dispute Resolution
- Item 18 – Public Figures

FDD Item 19 – Financial Performance Representations

- Review FTC Requirements and NASAA FPR Commentary
- Reasonable Basis
 - Representative Group
 - Time Period
 - # & % of Outlets Achieving the Stated Performance
 - Median (also High/Low for Gross Sales)
 - Other Material Information
- Substantiation

Items 20 - 23

- Item 20 – Outlets and Franchisee Information
- Item 21 – Financial Statements
 - Phase-in of Audited Financials for New Franchisors
- Item 22 – Contracts
- Item 23 – Receipts

State-Specific Disclosure Requirements

- Jurisdiction of State Franchise Laws – No Federal Pre-emption
- Examples of State-Specific Disclosures
- State Cover Page/Risk Factors
- State Addenda
- State Timing Issues

State Franchise Registrations

- 14 states – Jurisdiction
- NASAA
- Filing Requirements
- Review Process/Comment Letters
- Strategies for Registration Process

FDD Renewal / Amendment Process

Federal Requirements

- Renewal
 - 120 days after fiscal year end
- Amendment
 - Quarterly to reflect any “material change”
 - FPRs: immediately notify prospect of change

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

Navigating Exemptions from Federal Disclosure Requirements

- Fractional Franchise
- Minimal Franchise Fee
- Large Franchisee
- Large Investment
- Others

Questions?

