



2024 > LEGAL
SYMPOSIUM

MAY 5-7 > WASHINGTON, DC



Basic Track: Registration & Disclosure

- Welcome
- Meet the speakers
- Get to know the audience

Basic Track: Registration & Disclosure

Key Topics

- Definition of a Franchise
- Federal and State Laws
- FDD Content Requirements
- FDD Timing and Delivery Requirements
- State Registration
- Amendments and Renewals
- Exemptions

The
Business

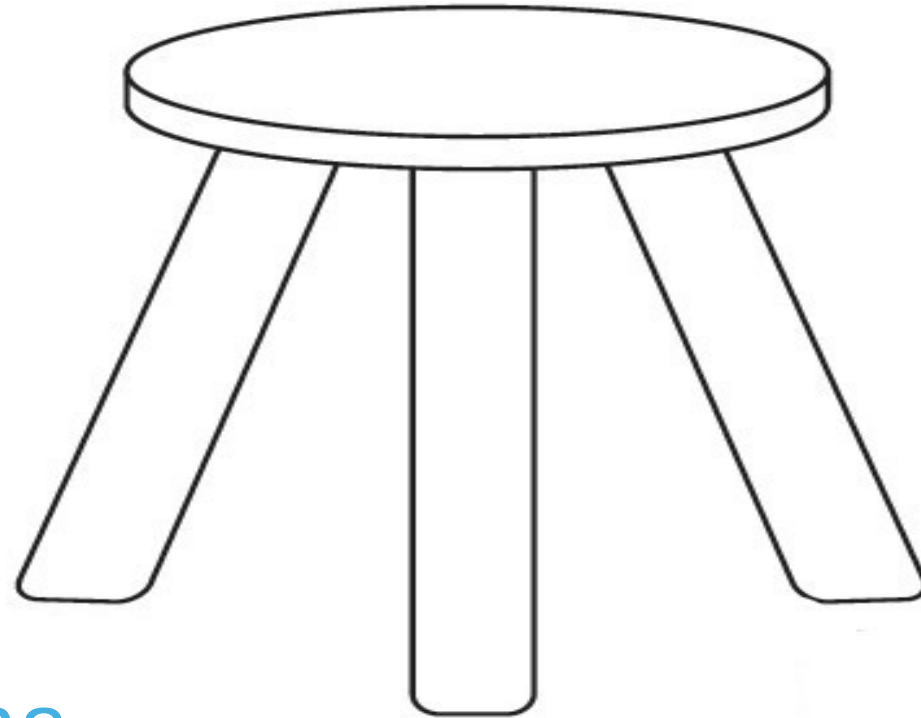


What is a Franchise?

Federal Trade Commission Elements

- 1) Trademark
- 2) Significant control or assistance
- 3) Required payment

Is it a Franchise?



Big Kahuna
Burger™



Initial Fee,
Royalty

Recipes, Suppliers,
Training, Support

It's a Franchise! Now What?

- FTC Franchise Rule
 - Disclosure Obligation
 - Anti-Waiver
 - No Private Right of Action
- State Laws
 - Disclosure
 - Registration



Drafting the FDD!

FDD Basics

- 23 “Items”
 - Describing franchisor and its principals, the franchise program, contractual obligations under the franchise agreement and other ancillary agreements
- Material Contracts
- Financial Statements
- Lists of Current and Former Franchisees
- Other Key Information

Where do we start?

FTC Resources

- [FTC Compliance Guide](#)
- [The Franchise Rule \(and its Amended Statement of Basis and Purpose\)](#)
- [FTC Amended Rule FAQs](#)
- [FTC Informal Advisory Opinions](#)

NASAA Resources

- NASAA
- NASAA
Guide
- NASAA
- NASAA
- NASAA
- NASAA
Quest



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losure

FDD Cover Pages

- FTC Cover Page
 - Explains purpose
 - Specific language required
 - Includes both the estimated initial investment and the range payable to the franchisor before the franchise opens
- State Cover Pages
 - “How to Use this Franchise Disclosure Document”
 - “What You Need to Know About Franchising, Generally”
 - “Special Risk(s) to Consider about this Franchise”

Item 1: The Franchisor, and any Parents, Predecessors, and Affiliates

- Background on Franchisor
- Information on Predecessors, Parents, and Certain Affiliates
- A Description of the Franchise Business
- Description of the Market/Competition
- Laws and Regulations

Item 2: Business Experience (People)

- Directors
- Principal Officers
- Trustees
- General Partners
- Individuals with Management Responsibility related to the sale or operation of a franchise



Hypotheticals

Item 2

- Do we need to include, Stephanie, the CEO of Big Kahuna Burger?
- Does Big Kahuna Burger need to disclose, Beatrix, an HR manager in charge of hiring for corporate?
- Does Big Kahuna Burger need to disclose, Jules, an employee of an affiliate, who will help manage franchise operations?

Items 3 and 4

- Item 3: Litigation
 - Certain Pending Actions
 - Certain Prior Actions within 10 Years
 - Current Governmental Actions
 - Franchisor-Initiated Actions Regarding Franchise Relationship
- Item 4: Bankruptcy

Items 5 and 6

- Item 5: Initial Fees
 - Paid Prior to Opening
 - Paid to Franchisor or its Affiliate (Not Third Parties)
 - Includes: Initial Franchise Fees, Inventory Payments, Initial Training Costs, Etc.
- Item 6: Other Fees
 - Paid During the Franchise Relationship (Excluding Initial Fees)
 - Paid to Franchisor or its Affiliate
 - Includes: Royalties, Marketing Fees, Ongoing Training Fees



Item 7: Estimated Initial Investment

- Chart Reflecting Total Estimated Investment to Open Franchised Business
 - Initial Franchise Fee
 - Furniture, Fixtures, Equipment
 - Training Costs
 - Insurance
 - Rent
- Includes Fees Paid to Franchisor, Franchisor's Affiliates, and Third Parties
- Most Fees are Presented in Low to High Ranges

Hypotheticals

Items 5-7

- Big Kahuna Burger charges an Initial Training Fee of \$2,000 for each person who attends training at Big Kahuna Burger headquarters. The initial training fees paid to Big Kahuna Burger must be included in which Item(s)?
- Franchisees and their personnel also will incur training costs to attend the Big Kahuna Burger training program (e.g., hotel, travel, etc.). Training costs for attending training must be included in which Item(s)?
- Big Kahuna Burger charges \$500 for ongoing training programs during the term of the Franchise Agreement. Training fees for ongoing training must be included in which Item(s)?

Item 8: Restrictions on Sources of Products and Services

- Required purchases
- Franchisor as supplier
- Officer ownership
- Approval procedure
- Standards and specifications
- Revenue earned by franchisor and its affiliates based on purchases and leases of franchisees (i.e., rebates)

Items 9 and 10

- Item 9: Franchisee's Obligations
 - Pre-established list
 - Highlights primary contractual obligations and the location of such information in the FDD and Franchise Agreement
- Item 10: Financing
 - Offering by franchisor, affiliates, or agents
 - Direct or indirect

Item 11: Franchisor's Assistance, Advertising, Computer Systems, and Training

- Franchisor's Pre-Opening and Ongoing Assistance
- Approximate Time to Open
- Operating Manual
- Training Program
- Computer Systems
- Advertising



Item 12: Territory

- Conditions of Relocation and Additional Outlets
- Plans for Competing System
- Exclusivity and Territorial Restrictions
- Alternative Methods of Distribution

Hypotheticals

Item 12

- An affiliate of Big Kahuna Burger plans to begin a business that franchises cupcakes. Does this need to be disclosed?
- An affiliate of Big Kahuna Burger already operates a business that franchises burger restaurants. Does this need to be disclosed?

Items 13 and 14

- Item 13: Trademarks
 - Principal Trademarks
- Item 14: Patents, Copyrights, and Proprietary Information
 - Intellectual Property
 - Confidential Information



That is a Tasty Burger!

Items 15 and 16

- Item 15: Obligation to Participate in the Actual Operation of the Franchise Business
 - Whether On-Premises Supervision is Required
 - Confidentiality and Non-Compete Requirements for Managers
- Item 16: Restrictions on What the Franchisee May Sell
 - Required Goods and/or Services
 - Restricted Goods and/or Services
 - Right to Modify

Items 17 and 18

- Item 17: Renewal, Termination, Transfer and Dispute Resolution
 - Table Format
 - Summary of Key Agreement Provisions

- Item 18: Public Figures
 - Name or Image
 - Investors

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....
- Reasonable Basis
 - No Cherry Picking
 - Time Period
 - # and % of outlets achieving the stated performance
 - Average/Median (and High/Low for Gross Sales)
 - Other Material Information
- Not a Required Disclosure

Item 19: Financial Performance Representations

- Formal Representations
 - Revenue, Profit, Sales, Income
 - Expenses (when presented as a % of sales)
 - Commenting on Proformas
- Informal Representations
 - Average customer counts
 - “You’ll make enough money to pay off your student loans!”



Hypotheticals

- Is it an FPR?
 - Money will no longer be an issue.
 - I'm confident you will have a 10% return on your investment.

Item 20: Outlets and Franchisee Information

- Table 1: Systemwide summary of number of outlets
- Table 2: Transfers by state
- Table 3: Changes in franchised outlets
- Table 4: Changes in company outlets
- Table 5: Projected opening by state
- Franchisee Associations

Items 21, 22, and 23

- Item 21: Financial Statements
 - GAAP
 - Last Three Fiscal Years
- Item 22: Contracts
- Item 23: Receipts

Hypothetical

The FDD is finally drafted! Can **Big Kahuna Burger** give a copy to Vincent Vega, a prospect, for the development and operation of a **Big Kahuna Burger** restaurant in DC and immediately sign the Franchise Agreement?

Timing for Disclosure

The 14-Day FDD Rule

- 14 calendar days to review the FDD before signing or paying consideration
- The “Sandwich Rule”
- Start counting on the day after the date listed on the FDD Receipt
- State law requirements may vary

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

Timing for Disclosure

The 7-Day Agreement Rule

- If franchisor unilaterally and materially changes standard agreement attached to FDD, must provide copy of revised agreement at least 7 calendar days before execution
- Fill-in-the-blank changes (non-substantive) do not trigger this requirement
- Changes resulting from negotiations do not trigger this requirement
- Sandwich Rule applies

Disclosure Rules

- Who Gets the FDD?
 - Prospective Franchisees: 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
- Advise Prospects of FDD Formats Before Delivery
- Electronic Disclosure
 - Includes email, internet (through franchisor or third-party website), and by CD-ROM
 - Permitted if FDD is one document
 - Must be in a form that permits prospect to store, download, print, or otherwise maintain the document for future reference
 - Must advise prospect regarding any technological requirements to access the FDD (e.g., specific browser version)

Receipts

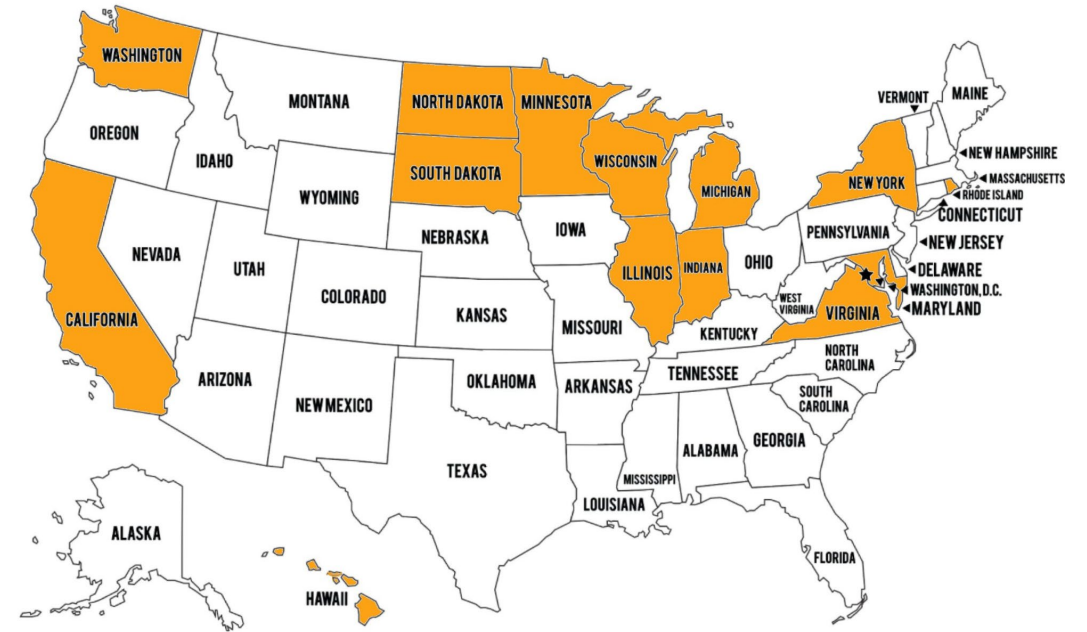
- Two copies attached to the FDD
- Must identify franchise seller(s)
- Must be signed and dated by prospective franchisee
- Franchisor must keep signed receipts for at least 3 years (but best practice is for the entire relationship)
- State law requirements may differ

Hypothetical

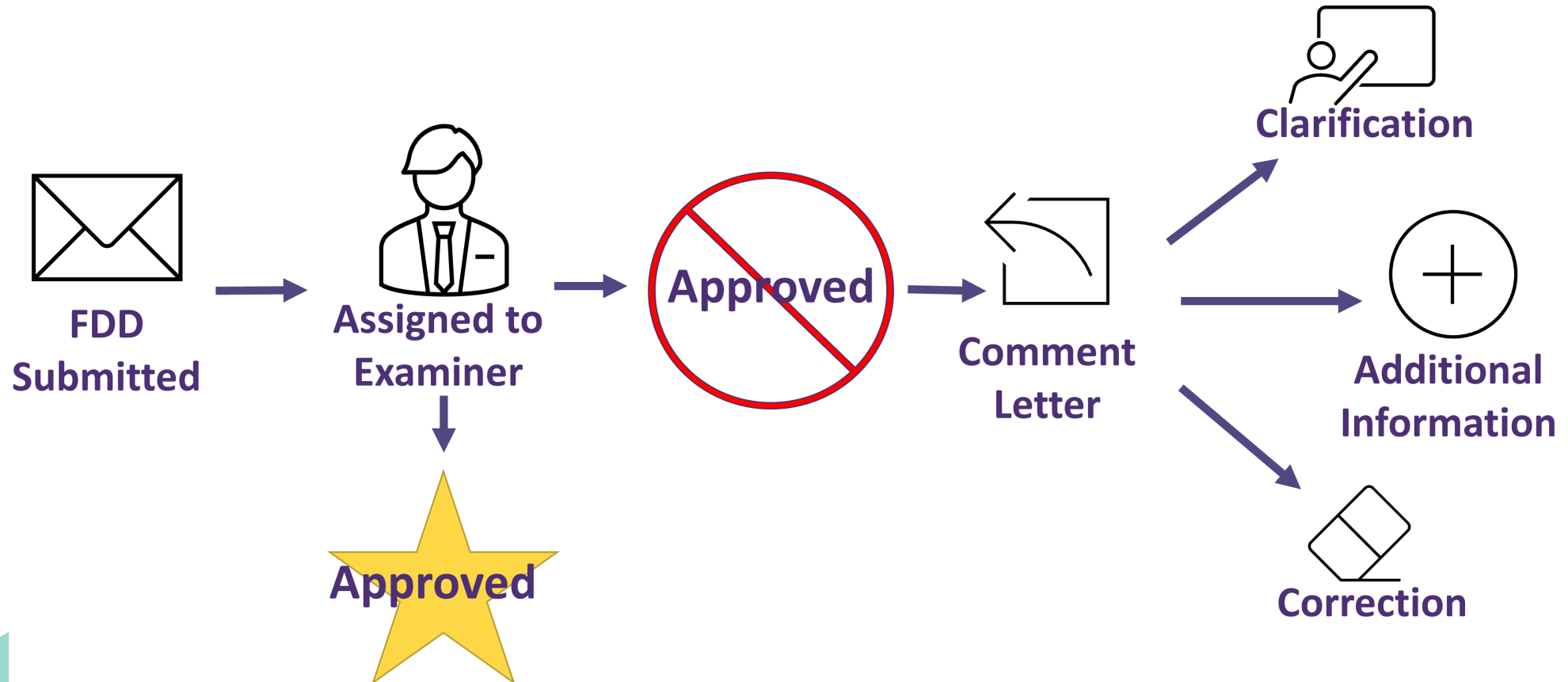
Can **Big Kahuna Burger** give a copy to Elle, another prospect, for the development and operation of a **Big Kahuna Burger** restaurant in Virginia or Maryland if it abides by the disclosure rules?

Registration States

- Cannot offer or sell franchises within certain states without first registering FDD with the state
- Registration states have varying requirements
- Online Filing
 - NASAA - Electronic Filing Depository (EFD)



Registration Process



State-Specific Disclosure Requirements

- Jurisdiction of State Franchise Laws
 - May depend on factors such as the location of franchisor, franchisee, franchisee's owners, the location of the franchised business, the territory, and where the offer and acceptance occurred
- State-Specific FDDs
- State Addenda
 - Common issues include notice and grounds for termination, choice of law, dispute resolution requirements, general releases, statutes of limitations, and financial assurance conditions

Amendments

- Material changes require an amendment to the FDD and filing with registration states
- A “material change” is one that has a substantial likelihood of influencing a reasonable franchisee or a reasonable prospective franchisee making a significant decision
- Timing requirements vary (quarterly, promptly, upon occurrence of a material change, within 30 days, etc.)
- Under the FTC Rule, amendments can be done by supplemental disclosure within reasonable time after the fiscal year ends (but state laws may require different procedure)

Examples of Material Changes

- Change in management (Item 2)
- Filing of material litigation (Item 3)
- Change in any franchise or other fee (Items 5 and 6)
- Significant increase in initial investment (Item 7)
- No longer have reasonable basis for FPR (Item 19)
- Significant adverse change in financial condition (Item 21)

Annual Renewal

- Federal Requirement: 120 days after fiscal year end
- State Requirements: Range from 90 to 120 days after fiscal year end

Federal Exemptions

- Fractional Franchise Exemption
- Minimum Payment Exemption
- Large Franchisee Exemption
- Large Investment Exemption
- Insiders Exemption

State Exemptions

- Exemptions Vary by State
- May apply to Registration and/or Disclosure
- Common Exemptions
 - Large Franchisor Exemption
 - Large Franchisee Exemption
 - Fractional Franchise Exemption
 - Large Investment Exemption
 - Exemption by Order



Violations of Federal Disclosure Requirement

- The following remedies may apply to a violation of the FTC Franchise Rule:
 - Damages and attorneys' fees
 - Cease and desist orders
 - Civil penalties up to \$40,000 per violation
 - Required franchise compliance training
 - Recession franchise agreements
 - Preliminary and/or permanent injunctions
 - Negative FDD disclosures



Violations of State Registration and/or Disclosure Requirements

The following may apply for violations of state franchise laws

- Civil liability (private right of action)
- Criminal liability
- Damages and attorneys' fees
- Cease and desist orders
- Preliminary and/or permanent injunctions
- Restitution
- Rescission
- Civil fines per violation
- Negative FDD disclosures



Questions?

Thank you!