

International Franchise Association  
56<sup>th</sup> Annual Legal Symposium  
May 5-7, 2024

---

**NOT YOUR FATHER'S FRANCHISE RULE? POTENTIAL CHANGES TO THE FTC RULE TO PROMOTE  
RESPONSIBLE FRANCHISING**

---

Authors:

**Sarah Davies**

International Franchise Association  
Washington, DC

**Ronald K. Gardner**

Dady & Gardner, P.A.  
Minneapolis, MN

**David W. Oppenheim**

Greenberg Traurig  
New York, NY

**Karen B. Satterlee**

Hilton Worldwide  
Singapore

**Table of Contents**

- I. Introduction ..... 4**
- II. Decennial Review of the Franchise Rule ..... 6**
  - A. Upgrades to the Format of the FDD ..... 7**
  - B. Executive Summary ..... 7**
  - C. Improved Readability ..... 8**
  - D. Technology Upgrades and Innovation ..... 9**
  - E. Disclaimers, Waivers and Other Recommended Revisions..... 10**
- III. FTC Public Workshop: Reviewing the Franchise Rule.....11**
  - A. Financial Performance Representations ..... 11**
  - B. Disclaimers, Waivers and Questionnaires ..... 12**
  - C. The Pros and Cons of the Current FDD Format ..... 13**
- IV. Summary of Franchise Rule Review Through the 2020 Workshop ..... 14**
- V. Disclosure Issues Raised in Response to the NASAA SOP ..... 14**
- VI. Disclosure Issues Raised in Response to the RFI ..... 15**
- VII. Permanent Pivots in the Pandemic and Disclosure Impossibilities ..... 15**
- VIII. Recent Case Law Involving Fraud and False Disclosure ..... 16**
  - A. Fraudulent Inducement and Misrepresentation ..... 16**
  - B. Non-Disclosure ..... 19**
- IX. FTC rulemaking process and amendments to the Franchise Rule ..... 20**
- X. Article 11 Working Group Recommendations for Changes to the FDD ..... 21**
  - A. Recommended Non-Substantive Changes to the FDD ..... 21**
    - 1. Enhance the use of Navigational Tools ..... 22**
    - 2. Permit the use of alternate forms of media..... 22**
    - 3. Increase document accessibility for Franchisees ..... 23**
    - 4. Reimagining the format of the FDD ..... 24**
      - a) Introducing an Executive Summary.....24**
      - b) Reorganizing the FDD.....25**
        - 1. What is the Franchise?..... 25**
        - 2. How much does it cost? ..... 26**
        - 3. How much will I make?..... 27**
        - 4. Is Franchisor financing available? ..... 27**
        - 5. If I become a Franchisee, what are your obligations to me?..... 27**
        - 6. If I become a Franchisee, what are my obligations to you? ..... 27**

7. How does the Franchise system operates? .....	28
8. What Intellectual Property do you own and what are your Technology requirements? .....	28
9. Who are your Franchisees? .....	28
10. What happens if I want to leave the system? .....	29
11. About us .....	29
12. Additional Information .....	29
13. Receipts .....	29
<b>B. Recommended Substantive Changes to The FDD .....</b>	<b>29</b>
<b>1. Recommended Additions to the Required Disclosures .....</b>	<b>29</b>
a) Disclosure Related to System Standard Changes.....	29
b) Disclosures Related to Supply Chain Issues.....	30
c) Suggestions to Eliminate Certain Disclosures.....	31
d) Third-Party Third Party Franchise Seller Disclosures.....	31
1. Types of Third Party Franchise Sellers .....	31
2. Individual Third Party Franchise Sellers: .....	31
3. Third Party Franchise Seller Networks: .....	32
4. Franchise Sales Organizations (“FSOs”):.....	32
5. Franchise Consulting Firms: .....	32
a) Current Disclosure Obligations for Third Party Franchise Sellers.....	32
b) Proposed Disclosure Requirements:.....	33
1. Definition of Third Party Franchise Seller .....	33
2. General Disclosures Regarding Third Party Franchise Sellers.....	34
3. Third Party Franchise Seller Specific Disclosure Requirements.....	34
<b>II. Conclusion.....</b>	<b>34</b>

## I. Introduction

There is no denying that franchising is a major force in the US economy. There are over 821,00 franchised locations in the United States. These franchised units will provide employment to over 8.9 million people in our communities. The total annual output of these franchised units is over \$893.9 billion and franchising's Gross Domestic Product is increasing by more than 4% each year, to \$545.8 billion in 2024.<sup>1</sup> With such a positive economic impact, it may come as a surprise that franchising is not universally seen as having a positive impact on members of the franchising community. In fact, in some quarters, the opposite view is held. Franchising has been criticized due to the perceived unequal bargaining power between Franchisors and Franchisees. Areas of dissatisfaction include concerns about encroachment, requirements relating to franchise supply chain management, opaque fees and changing system standards. It is in this environment that we find the Amended Franchise Rule<sup>2</sup> subjected to its decennial review by the Federal Trade Commission ("FTC") along with the March 13, 2023's Request for Information ("RFI")<sup>3</sup> which may portend more onerous disclosure requirements or even the release of a Federal Franchise Relationship Rule.

There are many views on the question of "how did we get here"? But the important question is not how we arrived at this destination, but rather how do we move the needle to ensure that the franchise business model is conducted in a manner that is responsible and sustainable.

The International Franchise Association's ("IFA") central mission is to protect, enhance and promote the franchise business model. Protecting the integrity of the franchise model requires considering the interests of all parties, and in particular, the interests of Franchisees. As articulated by former IFA Chairman David Humphrey, "franchising only works when everyone succeeds together."<sup>4</sup> The franchise model will not succeed if Franchisors engage in opportunistic selling to inadequately informed franchise candidates. Franchising only succeeds when the entire franchise community pulls together to collectively to protect the franchise model by advancing the cause of responsible franchising.

Responsible franchising is reflected in the IFA's Statement of Guiding Principles. These principles are the roadmap to fulfilling the IFA's mission to protect, enhance, and promote franchising. All members of the franchise community have a role to play in this process. As IFA Chief Executive Office Matthew Haller recently wrote:

*Franchisors must grow and scale responsibly and turn away prospective buyers that are not the right fit for their systems. Franchisors must also possess a high-risk tolerance and willingness to fully immerse themselves in the system and standards integral to sustaining their brands. They must believe in themselves, their franchise system, and their Franchisees. That responsibility must extend to those in private equity firms whose portfolio companies include Franchisors but also by extension Franchisees of the systems they acquire. Finally, responsibility extends to those suppliers involved in the franchise sales process, including Third Party Franchise Sellers and third party franchise seller networks, franchise sales organizations and others.*

---

<sup>1</sup> The IFA's 2024 Franchising Economic Report. [2024 Franchising Economic Report.pdf \(franchise.org\)](https://www.ifa.com/2024-Franchising-Economic-Report.pdf).

<sup>2</sup> FEDERAL TRADE COMMISSION, *Disclosure Requirements and Prohibitions Concerning Franchising*, 16 C.F.R. 436 (2007).

<sup>3</sup> FED. TRADE COMM'N, *Solicitation for Public Comments on Provisions of Franchise Agreements and Franchisor Business Practices* (Mar. 10, 2023), [https://www.ftc.gov/system/files/ftc\\_gov/pdf/Franchise-RFI.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/Franchise-RFI.pdf)

<sup>4</sup> IFA Annual Convention, Las Vegas, NV 2022.

Meanwhile, prospective Franchisees—those considering buying into a franchise system—must do their due diligence on a system with guidance from a franchise attorney before committing to a long-term franchise relationship. Once in the system, they must follow the system standards to protect their investment and the investments of their fellow Franchisees.

To be clear: federal and state governments have a role to play here too. Regulators must evolve the disclosure framework to changing market conditions and consumer preferences while ensuring Franchisors can better explain to Franchisees their brand and the obligations of each party in the ongoing relationship.....<sup>5</sup>.

It was within this spirit, and in conjunction with the decennial review of the Amended Rule as well as the Request for Information, that the IFA created a working group (“the Article 11 Working Group”) to review the current franchise disclosure requirements (“FDD”), including the format of the FDD, to see what improvements could be made to franchise disclosure in the United States. For context, Article 11 of the Statement of Guiding Principles states:

Improved pre-investment disclosure will benefit both prospective Franchisees and Franchisors by enhancing the competition among Franchisors for qualified Franchisee candidates. By clearly communicating the terms contained in a Franchise offering, prospective Franchisees will be better able to evaluate and make investment choices among the wide range of franchise opportunities available to them and to choose from those that meet their goals, ambitions, financial and other requirements.

With improved disclosure and enhanced communication, the franchise community can address any alleged misconception about the franchise model, namely that franchise relationships are imbalanced in favor of Franchisors, inherently unfair, and broken. It is with this principle in mind that the Article 11 Working Group commenced our review, beginning with considering the purpose of the Amended Rule and providing presale disclosure to prospective Franchisees.

The original franchise rule was adopted on December 21, 1978 to combat “widespread deception in the sale of franchises and business opportunities through both material misrepresentations and nondisclosures of material facts”<sup>6</sup>. Misrepresentations typically concerned: 1) the nature of the Franchisor and its business operations; 2) the costs required to purchase a franchise; 3) the Franchisor’s financial viability; 4) false or unsubstantiated earnings claims; and/or 5) Franchisors’ failure to honor promised refund requests, all damaging prospective Franchisees.<sup>7</sup> To curb deceptive and unfair practices in the sale of franchises, the FTC adopted the original Franchise Rule, which requires a set of mandatory pre-sale disclosures designed to assist prospective Franchisees in making an informed decision prior to purchasing a franchise.

On March 30, 2007, the FTC issued the Amended Rule incorporating changes designed to “streamline the Rule, minimize compliance costs, and to respond to changes in new technologies and market conditions in the offer and sale of franchises.”<sup>8</sup> These changes included providing for electronic disclosure,

---

<sup>5</sup> Matthew Haller, *Responsible Franchising Is Our Collective Responsibility*, LINKEDIN (Dec. 11, 2023), <https://www.linkedin.com/pulse/responsible-franchising-our-collective-responsibility-matthew-haller-dejisc/?trackingId=wfxnh8MEQrWCn3KvfkXshA%3D%3D>.

<sup>6</sup> FED. TRADE COMM’N, *Statement of Basis and Purpose*, 43 FR 59621, 59625 (Dec. 21, 1978) (the “Original SBP”).

<sup>7</sup> *Id.* at 59627–39.

<sup>8</sup> FED. TRADE COMM’N, *Disclosure Requirements and Prohibitions Concerning Franchising* 16 C.F.R. 436 *et seq.*, 72 Fed. Reg. 15444 (March 30, 2007).

increased disclosure about Franchisor-initiated litigation against Franchisees, territorial rights, confidentiality obligations and disclosure exemptions for certain Franchisor types, Franchisees and transactions.

In short, the rules established by the FTC continue to be designed to provide Franchisees with sufficient information to make informed purchasing decisions and to protect prospective Franchisees from fraud in a cost-effective way by providing material information to prospective Franchisees about “the costs, benefits, and potential legal and financial risks associated with entering into a franchise relationship”.<sup>9</sup>

The Article 11 Working Group has developed a series of recommendations for improving the Amended Rule to achieve the stated goals of the FTC as part of a broader IFA initiative of promoting responsible franchising. These recommendations are both substantive and non-substantive in nature, which are set forth in Section IX of this paper. In support of these recommendations, the authors will walk the reader through a cross section of public comments made by trade associations, Franchisor counsel, Franchisee counsel, Franchisees, brands and NASAA in response to the decennial review of the Amended Rule. The authors will also discuss the 2023 RFI, the FTC rulemaking process, the key areas of focus of the 2020 workshops held by the FTC, recent case law on fraud and disclosure and conclude with proposed new disclosure requirements for Third Party Franchise Sellers.

## **II. Decennial Review of the Franchise Rule**

In connection with its regulatory review of the Amended Rule, the FTC sought public comment in February 2019 on: (A) whether the need for the Amended Rule continues; (B) the benefits of the Amended Rule for small businesses; (C) whether the Amended Rule should be modified; (D) the impact of the Amended Rule on the flow of truthful versus deceptive information to prospective Franchisees; (E) the costs of the Amended Rule to Franchisees and any modifications that should be considered to reduce those costs; (F) the benefits of the Amended Rule to Franchisees and Franchisors, and what modifications should be made to increase the benefits to Franchisors, franchise sellers and Franchisees; (G) evidence demonstrating compliance with the Amended Rule and the associated costs of compliance incurred by Franchisors and franchise sellers, including whether modifications should be made to reduce such costs; (H) whether modifications should be made to the Amended Rule to account for changes in relevant technology or economic conditions; and (I) whether the Amended Rule conflicts or overlaps with any other federal, state or local laws or regulations.<sup>10</sup> The FTC published to the rulemaking record 41 of the 46 comments received in response to its request, comprised of comments submitted by representatives of all key stakeholders to franchising, including Franchisors, Franchisees, and suppliers to franchise companies, all of which voiced support for continuation of the Amended Rule.<sup>11</sup> Beyond alignment on retaining the Amended Rule, comments varied widely in response to the questions posed by the FTC: at one end of the spectrum, a commenter recommended that the Amended Rule remain unchanged, and at the other end, several commenters recommended a complete overhaul of the Amended Rule. Most commenters fell in the middle, recommending a few strategic revisions, many of which form the basis of the Article 11 Working Group recommendations.

---

<sup>9</sup> FED. TRADE COMM’N, *Statement of Basis and Purpose*, 16 C.F.R. 15444, 15445 (Mar. 30, 2007) (the “Amended SBP”).

<sup>10</sup> FED. TRADE COMM’N, *Disclosure Requirements and Prohibitions Concerning Franchising*, Fed. Reg. 84 FR 9015 (Mar. 13, 2019).

<sup>11</sup> FED. TRADE COMM’N, *Rulemaking Docket: FTC Seek Comments on Franchise Rule Regulatory Review*, 16 CFR Part 436, Matter No. R511003, <https://www.regulations.gov/docket/FTC-2019-0014/comments>.

## A. Upgrades to the Format of the FDD

The recommendation most consistently included in the comments by Franchisor attorneys, Franchisee attorneys, regulators and consultants to franchise companies is an update of the format of the FDD consistent with currently available technology to improve accessibility of franchise disclosures.<sup>12</sup> As many commenters aptly note, disclosure of complex information about a franchise offering that often spans hundreds of pages in hard copy or PDF with limited search features is likely a key contributing factor to many Franchisees electing to not read the FDD. The format of franchise disclosures is largely based upon the needs of purchasers decades ago, when prospective Franchisees would be forced to rely on libraries and public records to conduct research about a franchise offering absent the current disclosure regime. Today, most people conduct research through the Internet across endless resources in a matter of minutes, and library research is a long-gone relic. Internet readers are unlikely to read hundreds of pages serially in a single document.<sup>13</sup>

Just as the franchise community was familiarizing itself with the requirements of the Amended Rule in 2007, the technology boom took the world by storm, with Apple launching the *original* iPhone the same year, Facebook and Twitter (now “X”) going global, the release of Android, and IBM’s creation of its first Artificial Intelligence system, Watson.<sup>14</sup> These developments upended public access to information, with the number of mobile subscriptions rapidly increasing to numbers exceeding the number of people for nearly the past decade<sup>15</sup>, and people looking to mobile devices to access everything from media to medical information to streamlining communication across borders. Consider the current state of technology—consumers now have access to the 15<sup>th</sup> generation of the Apple iPhone, Artificial Intelligence technologies have infiltrated information sources to provide a streamlined flow of information to consumers customized to their personal preferences and interests, and institutions of higher learning have largely moved away from the use of textbooks entirely. Yet, franchise disclosures remain unchanged. It is not surprising that presenting a document hundreds of pages in length to a prospective Franchisee, laden with heavily footnoted charts and dense legal information, is often not reviewed.

## B. Executive Summary

---

<sup>12</sup> Lee Plave-Plave Koch PLC, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising*, (Mar. 12, 2019), Jonathan Solish-Bryan Cave Leighton Paisner LLP, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0040>; Martin Mansfield, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (May 13, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0036>; Peter Lagarias-Lagarias, Napell & Dillon, LLP, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0002>; Michael Pieciak, North American Securities Administrators Association, Inc., *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (May 13, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0032>; William Sentell-Polsinelli PC, *Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0034>; Sandy Wall-DLA Piper, LLP, *Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Apr. 21, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0004>; Keith Miller, Franchisee Advocacy Consulting, *Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0026>.

<sup>13</sup> Jonathan Solish-Bryan Cave Leighton Paisner, LLP, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising*, (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0040>.

<sup>14</sup> Lizzy Gurdus, *Your world changed forever in 2007, get with the program, Thomas Friedman says*, CNBC (Nov. 22, 2016), <https://www.cnbc.com/2016/11/22/your-world-changed-forever-in-2007-with-iphone-and-tech-boom-thomas-friedman.html>.

<sup>15</sup> Felix Richter, *Charted: There are more mobile phones than people in the world*, WORLD ECONOMIC FORUM (Apr. 11, 2023), <https://www.weforum.org/agenda/2023/04/charted-there-are-more-phones-than-people-in-the-world/#:~:text=According%20to%20the%20International%20Telecommunication,phones%20subscriptions%20overtook%20population%20figures..>

Several commenters also renewed the call for a summary franchise disclosure document similar to a summary prospectus used in securities offerings to make wading through hundreds of pages of franchise disclosures more efficient<sup>16</sup>, or, alternatively, moving the tables contained in Items 9 and 17 to the beginning of the FDD to provide a roadmap to the reader to locate certain provisions in the FDD and franchise agreement.<sup>17</sup> Commenters also recommend making certain disclosure sections and information accessible via hyperlink to facilitate efficient navigation through the FDD.<sup>18</sup>

While there has previously been opposition to a franchise disclosure summary because it may discourage prospective Franchisees from reading the full FDD and dissuade them from conducting adequate due diligence of franchise opportunities<sup>19</sup>, the current technological environment of Artificial Intelligence tools like ChatGPT and Gemini being used to quickly compare the terms of franchise agreements and FDDs<sup>20</sup> calls that logic into question. It is time to rethink the position on providing a franchise disclosure summary to assist prospective Franchisees in navigating the FDD.

### C. Improved Readability

Another common theme among commenters from both sides of the aisle is the need to improve readability of the FDD. The North American Securities Administrators Association (NASAA) has observed the length and complexity of FDDs increasing in the last 25 years as a result of Franchisors incorporating single unit and multi-unit franchise offerings into a single FDD, the inclusion of numerous ancillary agreements (even those that only some Franchisees may sign), pre-emptive disclosures for obligations that *may* be imposed or fees that *may* be charged in the future, and complicated corporate structures due to consolidation of Franchisors by private equity firms that identify numerous affiliates and describe complex securitization transactions.<sup>21</sup> The increasing length and complexity are key contributing factors to the prospective Franchisees declining to read or struggling to understand FDDs. NASAA notes that while the cost to Franchisors to produce a more readable FDD is uncertain, it is clear that the benefits to Franchisees would be considerable.<sup>22</sup>

Another commenter similarly noted that the “logical order of the disclosure document provides no information to compel the reader to continue reading” and recommended a re-design of the layout of the disclosure information.<sup>23</sup> The need for readability of complex information to evolve is not unique to franchising, and lessons may be drawn from other industries, including making information relatable (i.e. storytelling) and contextualizing it.<sup>24</sup> For example, a TED speaker contextualized a talk about a new and

---

<sup>16</sup> See Eric H. Karp and Ari N. Stern, *A Proposal for a Mandatory Summary Franchise Disclosure Document*, 35 FRANCHISE L. J. 4, 541-576 (Spring 2016); cf Carl E. Zwisler, John J. McNutt, and Frank J. Sciremammano, *A Proposed Mandatory Summary Franchise Disclosure Document: A Solution in Search of a Problem*, 36 FRANCHISE L. J. 3, 465-489 (Winter 2017).

<sup>17</sup> *Supra* note 15.

<sup>18</sup> *Id.*

<sup>19</sup> Carl E. Zwisler, John J. McNutt, and Frank J. Sciremammano, *A Proposed Mandatory Summary Franchise Disclosure Document: A Solution in Search of a Problem*, 36 FRANCHISE L. J. 3, 465-489 (Winter 2017).

<sup>20</sup> Eleanor Vaida Gerhards, *How Franchisors Can use Artificial Intelligence (AI) to Improve their Franchise Systems and Help Franchisees*, FOX ROTHSCHILD FRANCHISE LAW UPDATE (Jun. 16, 2023), <https://www.jdsupra.com/legalnews/how-Franchisors-can-use-artificial-8960408/>.

<sup>21</sup> Michael Pieciak-North American Securities Administrators Association, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0032>.

<sup>22</sup> *Id.*

<sup>23</sup> *Supra* note 15.

<sup>24</sup> Matt Abrahams, *How to Make Complex Ideas More Accessible*, STANFORD UNIV. GRADUATE SCHOOL OF BUSINESS (Feb. 14, 2020) <https://www.gsb.stanford.edu/insights/how-make-complex-ideas-more-accessible>.

complicated medical treatment for age-related diseases by first sharing a story about his experience with his father's Alzheimer's disease progression, making the topic relatable to an audience of laypeople.<sup>25</sup> Similarly, the FDD is intended to communicate a story to the layperson about the franchise opportunity, yet in many cases it has evolved into a cumbersome scavenger hunt for information of the initial investment and continuing fees a Franchisee may expect to pay (appearing in Items 5, 6, 7, 8 and 11), evaluation of true initial investment costs depicted in Item 7 with the expected time to opening described in Item 11, analysis of financial performance representations in Item 19 against initial investments costs in Item 7 and the obligation to participate in the operation of the business in Item 15, and the stability of the franchise system across confusing tables in Item 20 read with the revenue streams received by the Franchisor in Item 21.<sup>26</sup> Existing disclosures fail to consider the audience—disclosures should align with the audience's knowledge level and prioritize what they care most about.

#### **D. Technology Upgrades and Innovation**

Separate from modifying the format of the FDD consistent with currently available technology to improve accessibility, several commenters recommended revisions to disclosure requirements to reflect the speed at which innovation and advancements in technology occurs today.<sup>27</sup> Many franchise agreements provide for an initial term of 20 years (or, ten years with the option to renew). Since 2010, technology solutions and innovations have emerged that could not have been contemplated 14 years ago, including: (A) introduction of 3G networks that quickly evolved into 5G networks, drastically reducing download time and increasing the range of mobile applications; (B) explosive growth of social media platforms and transformation of marketing to include influencers and content creators; (C) widespread adoption of AI and big data, driving the utility of social media, search engines and e-commerce; and (D) shifts in transportation to autonomous, electric and shared, reducing transportation and shipping costs for those able to leverage large volume shipping; and (E) integration of robotics in manufacturing, warehousing and distribution, optimizing supply chains.<sup>28</sup>

Because it is impossible to predict technology advancements, Franchisors need the flexibility to introduce systemwide innovations and upgrades to technology solutions to remain competitive with non-franchised businesses within the same industry, but those innovations and upgrades are often met with resistance from Franchisees when the innovations and upgrades were not included in the FDD received by the Franchisees when their franchise agreements were signed. However, restricting a Franchisor's ability to implement such innovations and upgrades without the approval of every Franchisee is unmanageable

---

<sup>25</sup> *Id.*

<sup>26</sup> See Caroline Fichter, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising*, (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0037>; Eric Karp- Witmer, Karp, Warner & Ryan LLP, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0010>; Howard Bundy, Bundy Law Firm PLLC, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0035>;

Martin Mansfield, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0036>

<sup>27</sup> See Lee Plave-Plave Koch PLC, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising*, (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0033>; Sandy Wall-DLA Piper, LLP, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising*, (Apr. 21, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0004>.

<sup>28</sup> Pedro Palandrani, *A Decade of Change: How Tech Evolved in the 2010s and What's in Store for the 2020s*, *Global X ETFFs*, NASDAQ (May 16, 2022), <https://www.nasdaq.com/articles/a-decade-of-change%3A-how-tech-evolved-in-the-2010s-and-whats-in-store-for-the-2020s>.

and prevents the franchise system's ability to react to market changes.<sup>29</sup> Because technological advancements vary significantly (as do the industries that may benefit from a certain technological advancement at any given point), imposing arbitrary limitations on Franchisors across all industries only serves to stifle innovation and position Franchisees at a disadvantage to their non-franchised competitors within the same industry. However, there are opportunities to improve disclosures regarding the innovations and upgrades a prospective Franchisee may be expected, perhaps based on disclosure of historical data of system innovations and upgrades.

#### **E. Disclaimers, Waivers and Other Recommended Revisions**

The recommendations of commenters described above are included in this paper because they garnered support from both representatives of Franchisees and Franchisors and provide context for the revisions to the Amended Rule discussed in Section IX. There are other recommendations proposed that warrant further discussion, particularly given the global pandemic that occurred since the 2019 comment period closed that forever changed consumer behavior, disparately impacting certain industries and the franchised businesses that operate within them still in recovery, including restaurants and health and fitness businesses, as further described in Section VII. Those recommendations include modification of the regulations related to financial performance representations, including incorporating NASAA's Commentary on Franchise Performance Representations ("FPR Commentary")<sup>30</sup> and suggested mandatory financial performance representations (with some commenters recommending mandatory disclosure of net profits, break-even data, substantiating documentation as part of the FDD, and debt service information)<sup>31</sup> or, alternatively, more robust negative disclosures for Franchisors that elect not to make financial performance representations.<sup>32</sup> Other commenters recommended evaluating whether disclosure of information in certain Items is valuable to prospective Franchisees as currently required, including lending disclosures in Item 10 (where lending already is heavily regulated under other federal laws), celebrity endorsements in Item 18, and the ambiguity of "exclusive" and "non-exclusive" territorial protections as defined in Item 12.<sup>33</sup> And, some commenters proposed broader change, including federal pre-emption of state registration and disclosure laws with enforcement reserved to the states<sup>34</sup>, a safe

---

<sup>29</sup> Jeffrey A. Brimer and Peter C. Lagarias, Change is Good? Franchisor and Franchisee Perspectives in Changing System Standards, American Bar Association 43 Annual Forum on Franchising (Oct. 27-30, 2020).

<sup>30</sup> *Supra* note 21.

<sup>31</sup> Peter Lagarias-Lagarias, Napell & Dillon, LLP, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising*, (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0002>; Eric Karp, Witmer, Karp, Warner & Ryan LLP, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0010>; Misty Chally-Coalition of Franchisee Associations, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0020>; Keith Miller-Franchisee Advocacy Consulting, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0026>; Jeffrey Goldstein, Goldstein Law Firm, PLLC, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising*, (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0039>.

<sup>32</sup> Eric Karp- Witmer, Karp, Warner & Ryan LLP, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising*, (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0010>.

<sup>33</sup> Lee Plave-Plave Koch LLP, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising*, (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0033>; Michael Pieciak, North American Securities Administrators Association, Inc., *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0032>

<sup>34</sup> Rochelle Spandorf, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0023>

harbor provision for immaterial omissions from the FDD<sup>35</sup>, a publicly accessible database of FDDs<sup>36</sup>, and certification by an officer of the Franchisor as to the accuracy and completeness of the information contained in the FDD.<sup>37</sup>

Widespread among comments submitted by Franchisee attorneys and representatives and NASAA is the recommendation that disclaimers and waivers should be prohibited<sup>38</sup>, as further discussed in Section III regarding the FTC’s 2020 Franchise Rule public workshop and Section V regarding NASAA’s Statement of Policy regarding the use of disclosure acknowledgements and questionnaires (the “SOP”).

### III. FTC Public Workshop: Reviewing the Franchise Rule

In November 2020, the FTC held a public workshop to review the Amended Rule featuring three panels, each presenting a Franchisor’s, Franchisee’s and regulator’s perspective on topics raised by commenters in response to the FTC’s 2019 request for comment: (A) whether financial performance representations should be disclosed and why, and if current Item 19 disclosure requirements are effective or whether additional or modified disclosures are necessary to prevent deception; (B) the use of disclaimers, waivers and questionnaires by Franchisors and whether such use undermines the Amended Rule’s protections; and (C) the pros and cons of the existing FDD format, including whether the format may be improved by alignment with current technological advances or other enhancements to readability.<sup>39</sup>

#### A. Financial Performance Representations

The workshop panelists uniformly agreed that financial performance representations *can* be useful to a prospective Franchisee, but as one panelist noted, each panelist viewed financial performance representations through their own prism in characterizing what information is useful.<sup>40</sup> There was general agreement that NASAA’s FPR Commentary should be incorporated into a revised Amended Rule,<sup>41</sup> but

---

<sup>35</sup> *Supra* n. 15

<sup>36</sup> Rochelle Spandorf, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0023>; Keith Miller-Franchisee Advocacy Consulting, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0026>; Jeffrey Goldstein, Goldstein Law Firm, PLLC, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising*, (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0039>; Caroline Fichter, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising*, (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0037>

<sup>37</sup> *Supra* n. 32.

<sup>38</sup> Peter Lagarias-Lagarias, Napell & Dillon, LLP, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0002>; ; Eric Karp- Witmer, Karp, Warner & Ryan LLP, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0010>; Caroline Fichter, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising*, (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0037>; Michael Pieciak, North American Securities Administrators Association, Inc., *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0032>; Keith Miller, Franchisee Advocacy Consulting, *Letter on Disclosure Requirements and Prohibitions Concerning Franchising* (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0026>; Jeffrey Goldstein, Goldstein Law Firm, PLLC, *Comment Letter on Disclosure Requirements and Prohibitions Concerning Franchising*, (Mar. 12, 2019), <https://www.regulations.gov/comment/FTC-2019-0014-0039>.

<sup>39</sup> FED. TRADE COMM’N, *Reviewing the Franchise Rule: An FTC Workshop* (Nov. 10, 2020), <https://www.ftc.gov/news-events/events/2020/11/reviewing-franchise-rule-ftc-workshop>.

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

little alignment otherwise. There was broad disagreement about whether financial performance representations should be mandatory and why a franchisor may elect to not provide financial performance representations, with some panelists asserting that the absence of financial performance representations is a sign the Franchisor is “hiding something” while other panelists noted that mature Franchisors may not make financial performance representations because the system is strong and growth is organic, whereas early-stage Franchisors may not make financial performance representations due to a lack of confidence in the reliability of system data.<sup>42</sup> The question of how to achieve a mandatory financial performance representation without resulting in some financial performance representations that are misleading or have no reasonable basis existed long before the 2020 FTC workshop and remains today. Considering the hundreds of industries in which franchise businesses operate, what may be reasonable in one industry may vary widely from what is reasonable in another industry.

The panelists also considered the prevalence of false financial performance representations presented to prospective Franchisees, many times through third party franchise sellers.<sup>43</sup> Some panelists cited to the the lack of financial performance representations in approximately 40% of FDDs as evidence of potentially false information reaching prospective Franchisees during the sales process.<sup>44</sup> The panelists agreed that increases in litigation and complaints to regulators are not due primarily to financial performance representations, although there was disagreement among the panelists as to whether the infrequency of litigation and complaints accurately reflected the prevalence of issues amongst Franchisees related to false or impermissible financial performance representations.<sup>45</sup> One panelists further noted that validation of financial performance representations with existing or former Franchisees is not reliable because many of them are subject to non-disparagement and non-disclosure agreements, a concern that has remained the focus of the FTC in recent years.<sup>46</sup>

But, if financial performance representations are mandated, at what cost—literally and figuratively? Some Franchisors that have been franchising for many years and have Franchisees operating on various point of sale systems under franchise agreements with varied terms would be faced with first implementing systemwide upgrades to ensure the data upon which financial performance representations are based is consistent systemwide. And other Franchisors who do not have the benefit of competent franchise counsel may be led to produce financial performance representations that are incomplete or inaccurate. Is a mandatory but bad financial performance representation better than no financial performance representation? As several panelists pointed out, financial performance representations are one factor of many considered by a prospective Franchisee, and if the absence of a financial performance representation without a legitimate explanation from the Franchisor as to why a financial performance representation is not made makes a prospective Franchisee uncomfortable, they may elect not to proceed with the investment.<sup>47</sup>

## **B. Disclaimers, Waivers and Questionnaires**

The 2020 workshop also explored the frequency with which Franchisors use waivers, disclaimers and questionnaires, both generally and specifically in Item 19, and whether modification of the Amended Rule was required to ensure more fulsome compliance with the existing prohibition of disclaimers. Given

---

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

NASAA's SOP adopted in 2022 and implemented in 2023 on this topic (discussed further in Section V), this paper does not delve into the substantive points raised by panelists during the workshop except to note extensive discussion and disagreement as to the responsibility of the Franchisee in the presale process to conduct its own due diligence, ideally with guidance from a franchise attorney.<sup>48</sup> The panelists further discussed the use of integration clauses in franchise agreements, with some panelists suggesting that integration clauses should not prohibit a Franchisee from later relying on information received during validation that the Franchisee was encouraged to conduct to support a claim that the franchise opportunity was misrepresented during the presale disclosure process.<sup>49</sup>

### C. The Pros and Cons of the Current FDD Format

The 2020 workshop closed with a discussion of accessibility and readability of the FDD, commencing with the impact of the length of the FDD on readability, with several panelists noting that FDDs have grown increasingly voluminous, often exceeding hundreds and sometimes thousands of pages.<sup>50</sup> The panelists also explored the addition of a summary document to provide guidance to a prospective Franchisee to find information within the FDD that is not readily ascertainable from the table of contents, and while there were mixed views of the utility of a summary disclosure document (with some panelists voicing concern that it may deter prospective Franchisees from reading the FDD), there was alignment among most of the panel that a list of key terms that Franchisees want to know about—fees, remodeling and capital improvement requirements, terminations, defaults and transfers—would be useful.<sup>51</sup> Panelists that expressed concern about the summary suggested instead tools like the FTC's Consumer Guide to Buying a Franchise<sup>52</sup>, although it is unclear that adding a 20-page document to the overall volume of pages a prospective Franchisee is provided to review for the franchise opportunity being considered is advancing the goal of increasing readability and comprehension. A practical point not discussed by the panelists is that prospective Franchisees often are evaluating multiple franchise opportunities, thereby navigating several voluminous FDDs comprised of hundreds (or thousands) of pages, attempting to compare terms.

A particularly salient point raised by one panelist is that the information disclosed in the FDD should be re-ordered, because while there may be a lot of good information in the FDD, "it's like someone took a shotgun and threw it up on the while and you have to go pick it out."<sup>53</sup> A prospective Franchisee may be 100 pages into an FDD for an established Franchisor that is part of a portfolio of brands and still be in Item 3, wading through a litigation history not readily apparent to the layperson of its meaning or relevance to evaluating the franchise system holistically.

The workshop closed with a discussion of technological features that might make the FDD more readable and accessible, with panelists pointing to features as simple as FDDs that are readable from mobile devices and hyperlinked tables of contents that assist in navigating through the FDD, including separate hyperlink paths for single unit versus multi-unit development.<sup>54</sup>

---

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>51</sup> *Id.*

<sup>52</sup> FED. TRADE COMM'N, *A Consumer's Guide to Buying a Franchise* (2020), [https://www.ftc.gov/system/files/documents/plain-language/591a\\_buying\\_a\\_franchise\\_sept\\_2020.pdf](https://www.ftc.gov/system/files/documents/plain-language/591a_buying_a_franchise_sept_2020.pdf).

<sup>53</sup> *Id.*

<sup>54</sup> *Id.*

#### **IV. Summary of Franchise Rule Review Through the 2020 Workshop**

From the nearly two-year Franchise Rule review period during which public comments were submitted across all key stakeholder groups and leaders in the franchise community debated key franchise issues before FTC staff, several trends emerged:

The current format of the FDD is in need of improvement to align with technological advancements that are now commonplace, like accessibility and readability of information via mobile devices and enhanced searchability functions to facilitate navigating voluminous FDDs.

The order of the information presented should be reconsidered so that it is logical, tells the story of the franchise system and compels a prospective Franchisee to continue reading.

An executive summary that provides a roadmap to a prospective Franchisee of how to navigate the FDD and where to find key terms of interest in addition to serving as a tool to efficiently compare franchise offerings should be explored.

Substantive improvements to disclosure requirements, particularly related to advancements in technology and innovation (including where such advancements and innovation require system upgrades and capital improvements), as well as disclosures related to the role of third-party franchise sellers in the franchise sales process, should be considered.

#### **V. Disclosure Issues Raised in Response to the NASAA SOP**

The NASAA SOP yielded 39 public comments, many of which identified the need for improved transparency during the franchise sales process, with several commenters citing the need for better disclosures related to the roles of third party franchise sellers in the sales process. Several commenters observed that prospective franchisees often misunderstand that third party franchise sellers are compensated by franchisors and have a vested interest in completing the sale regardless of the best interest of the prospective franchisee.<sup>55</sup> Another commenter cites to gaps in the disclosure regime that allow third party franchise sellers to present franchise opportunities without the restrictions that apply to franchisors.<sup>56</sup> Finally, a commenter points to financial performance representations made by third party franchise sellers that are not reflected in the FDD as an issue warranting greater transparency in the franchise sales process and the role of franchise sellers.<sup>57</sup> These concerns sparked increased focus by regulators and the franchise community on the role of third party franchise sellers by all stakeholders in

---

<sup>55</sup> Bruce Holzman, *Comment on Proposed Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgements* (Dec. 23, 2021), <https://www.nasaa.org/wp-content/uploads/2021/12/PROPOSED-STATEMENT-OF-POLICY-REGARDING-THE-USE-OF-FRANCHISE-QUESTIONNAIRES-AND-ACKNOWLEDGMENTS.pdf>;

Jeffrey S. Haff, Dady & Gardner, P.A., *Comment on Proposed Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgements* (Jan. 4, 2022), <https://www.nasaa.org/wp-content/uploads/2021/12/NASAA-JSH-Proposed-Statement-of-Policy-Comments.pdf>.

<sup>56</sup> Sean Kelly-Franchise Truth, *Comment on Proposed Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgement* (Dec. 21, 2021), <https://www.nasaa.org/wp-content/uploads/2021/12/Sean-Kelly-Ltr-to-NASAA-010222.pdf>.

<sup>57</sup> Keith Miller, Franchisee Advocacy Consulting, *Comment on Proposed Statement of Policy Regarding the Use of Franchise Questionnaires and Acknowledgements* (Jan. 4, 2022), <https://www.nasaa.org/wp-content/uploads/2021/12/NASAA-Request-for-Comment-on-Franchise-Questionnaires-and-Acknowledgments-Keith-Miller.pdf>.

franchising, including third party franchise sellers that practice responsible franchising and serve as mentors and strategic growth advisors to emerging franchisors, leading to proposed legislation in California (as further described in Section IX).

## **VI. Disclosure Issues Raised in Response to the RFI**

In the RFI, the FTC sought information regarding various aspects of the franchise relationship, as discussed further in Section VI. There were over 5,000 comments submitted in response to the RFI, of which the FTC published approximately 2,200. And, while the comments provided anecdotal accounts of positive and negative aspects of franchise relationships, they also highlighted the opportunities for improvement in presale disclosures. For example, one commenter notes concern with the lack of transparency into the incentives received by third party franchise sellers that may influence the franchise opportunities presented to a prospective franchisee as well as inadequate disclosures regarding the time and engagement required of franchisees in operating the franchised business.<sup>58</sup> Other commenters expressed concern in the lack of visibility into revenue received by franchisors and their affiliates in connection with required purchases of products and services as well as the methods used by franchisors to implement system changes.<sup>59</sup> One commenter proposes disclosure of franchisee bankruptcy by location as an indicator of franchise system health.<sup>60</sup> With continuing increase in private equity investment in franchising and expansion of portfolio franchise companies, several commenters expressed concern regarding disclosures related to ownership of competitors and encroachment issues arising from system acquisitions.<sup>61</sup>

These examples are just a few of many concerns with disclosures provided to franchisees in evaluating a franchise opportunity. The frequent appearance of concerns regarding visibility into supply chain management, system standard changes, and territorial protections as shifts in franchise system ownership occur beg the question of whether there is a communication problem rather than relationship problem.

## **VII. Permanent Pivots in the Pandemic and Disclosure Impossibilities**

The COVID-19 pandemic yielded numerous examples of significant system changes that were never contemplated in FDDs, yet somehow, franchisors and franchisees made them work. In the throes of a crippling global crisis, franchisors and franchisees were able to collaborate to keep their businesses and

---

<sup>58</sup> Aimee Bearden, *Comment on Solicitation for Public Comments on Provisions of Franchise Agreements and Franchisor Business Practices* (Jun. 21, 2023), <https://www.regulations.gov/comment/FTC-2023-0026-1576>.

<sup>59</sup> Anonymous, *Comment on Solicitation for Public Comments on Provisions of Franchise Agreements and Franchisor Business Practices* (Mar. 9, 2023), <https://www.regulations.gov/comment/FTC-2023-0026-1590>; Independent Association of Home Instead Franchisees, Inc., *Comment on Solicitation for Public Comments on Provisions of Franchise Agreements and Franchisor Business Practices* (Jun. 26, 2023), <https://www.regulations.gov/comment/FTC-2023-0026-1943>; North American Association of Subway Franchisees (NAASF), *Comment on Solicitation for Public Comments on Provisions of Franchise Agreements and Franchisor Business Practices* (Mar. 9, 2023), ; <https://www.regulations.gov/comment/FTC-2023-0026-2123>; Sudha Mani, *Comment on Solicitation for Public Comments on Provisions of Franchise Agreements and Franchisor Business Practices* (Jun. 25, 2023), <https://www.regulations.gov/comment/FTC-2023-0026-1734>

<sup>60</sup> Sudha Mani, *Comment on Solicitation for Public Comments on Provisions of Franchise Agreements and Franchisor Business Practices* (Jun. 25, 2023), <https://www.regulations.gov/comment/FTC-2023-0026-1734>

<sup>61</sup> Joseph Forth, *Comment on Solicitation for Public Comments on Provisions of Franchise Agreements and Franchisor Business Practices* (Jun. 26, 2023), <https://www.regulations.gov/comment/FTC-2023-0026-1955>; Anonymous, *Comment on Solicitation for Public Comments on Provisions of Franchise Agreements and Franchisor Business Practices* (Jun. 26, 2023) <https://www.regulations.gov/comment/FTC-2023-0026-1552>.

franchise systems afloat through innovative shifts in business operations and product and service offerings, all with little care to the presale disclosures. Restaurants went all-in on third party delivery service offerings.<sup>62</sup> Gyms and boutique fitness shifted to on-demand offerings to keep members engaged with their brands.<sup>63</sup> Hotels changed operational protocols and service offerings to accommodate consumer concerns and provide for more outdoor amenities.<sup>64</sup> Many of the changes made during the pandemic have become permanent fixtures of those industries. Franchise companies within those industries adapted to the changes, bringing along the franchisors and franchisees that operate within them. But, how?

Now that the pandemic is comfortably in the rear-view mirror, perhaps it is time to examine the lessons learned in franchisor-franchisee relationship management, with a specific eye toward implementing system standard changes. Undoubtedly, franchise brands each did this in their own way, responding to the unique demands of their consumers and navigating change in the way that worked for their franchisees, without regard to franchise disclosures provided years earlier. The need for system-specific flexibility highlights the concern with regulations that may apply across franchise systems and industries, but the opportunities for franchisors and franchisees to do better within their systems should not be ignored. As the dawn of the next global change is approaching with the integration of Artificial Intelligence, we should examine how to reimagine the disclosure regime to allow franchise systems to evolve and implement change as markets demand, incorporating the lessons learned from navigating COVID-19 challenges.

## VIII. Recent Case Law Involving Fraud and False Disclosure

The past five years have yielded a number of claims brought against Franchisors related to fraud. In this portion of our paper, we have attempted to give you a survey that highlights the many different ways fraudulent (real and alleged) manifests itself when it comes to franchise disclosure obligations.

### A. Fraudulent Inducement and Misrepresentation

We begin with a case that focuses on fraudulent inducement. In *Travelodge Hotels, Inc. v. Durga, LLC*.<sup>65</sup>, Travelodge Hotels, Inc. (“Travelodge”) entered into a franchise agreement with Durga, LLC (“Durga”) under which Durga would operate a Travelodge hotel. Travelodge stated that it provided customers with access to a “guest lodging facility” franchise network. Its franchise system is based on and utilizes federally registered trade names, service marks, logos, and derivations thereof, as well as a proprietary reservation platform.

Under the franchise agreement, Travelodge could terminate the agreement early under two circumstances, including discontinuation of operations as a Travelodge by the Franchisee. In such an

---

<sup>62</sup> Keenan Marchesi, *Pandemic-Related Increase in Consumer Restaurant Spending Using Mobile Apps Continued Through 2022*, ECONOMIC RESEARCH SERVICE, U.S. DEPT OF AGRICULTURE (Jan. 23, 2024), [https://www.ers.usda.gov/amber-waves/2024/january/pandemic-related-increase-in-consumer-restaurant-spending-using-mobile-apps-continued-through-2022/#:~:text=At%20quick%2Dservice%20restaurants%2C%20third,\(October%E2%80%93December%202022\)](https://www.ers.usda.gov/amber-waves/2024/january/pandemic-related-increase-in-consumer-restaurant-spending-using-mobile-apps-continued-through-2022/#:~:text=At%20quick%2Dservice%20restaurants%2C%20third,(October%E2%80%93December%202022).).

<sup>63</sup> Mark Stein, *The Transformation of the Fitness Industry*, N.Y. TIMES (Oct. 19, 2021), <https://www.nytimes.com/2021/10/19/business/fitness-industry-remote.html>.

<sup>64</sup> Marissa Mendez, “7 Ways Hotels are Changing Because of the Coronavirus,” U.S. News & World Report (Feb. 2, 2021), <https://travel.usnews.com/features/7-ways-hotels-are-changing-because-of-the-coronavirus>.

<sup>65</sup> *Travelodge Hotels, Inc. v. Durga, LLC*, No. CV 15-8412, 2023 WL 314313, at \*3 (D.N.J. Jan. 19, 2023).

event, Durga would have to pay Travelodge liquidated damages and reimburse Travelodge for any outstanding fees and costs.

Durga stopped operating his hotel as a Travelodge location and subsequently refused to pay Travelodge the liquidated damages and outstanding costs. In response, Travelodge filed suit, seeking damages for breach of contract and unjust enrichment. Travelodge moved for partial summary judgment on three of the six counts it asserted: to recover liquidated damages, to recover recurring fees, and for breach of the guaranty agreement.

Durga argued the contract was voidable because Travelodge fraudulently induced Durga to enter into the franchise agreement. Specifically, Durga argued that Travelodge's representatives promised orally and via email that Durga could rebrand the hotel from a Travelodge to another brand managed by the Wyndham Hotel Group. Durga claimed that its representatives were told that operating as a Travelodge was temporary and that they could convert the Hotel to a Days Inn or Ramada in the future. Durga stated that when they requested to convert the hotel to another brand, Travelodge subsequently refused to consent.

The Court ultimately ruled that Durga had raised sufficient issues of material fact as to whether they were fraudulently induced to enter into the franchise agreement. The Court denied Travelodge's motions for summary judgment on several counts, and the case is ongoing. This case demonstrates that fraud claims can withstand motions for summary judgment if sufficient evidence is presented and the false statement informs the decision to enter into a franchise relationship.

Another case in which the Franchisee survived a motion to dismiss was *Functional HIIT Fitness, LLC v. F45 Training Incorporated*.<sup>66</sup> In that case, the Franchisee (Functional HIIT Fitness) alleged that they had been induced into signing several agreements with the Franchisor. The Franchisee supported its claims with evidence that it had received and relied on an outdated Franchise Disclosure Document when entering into the first two agreements. Still, it did not receive any Franchise Disclosure Document before entering into the third agreement.

In addressing the fraud and misrepresentation claims, the magistrate court recommended that the district court deny the Franchisor's motion to dismiss. The Court concluded that those claims were properly based on information provided to the Franchisee by the Franchisor in its Franchise Disclosure Document, in statements made by F45 officers, and in a spreadsheet related to financial modeling. The magistrate court concluded that Functional Fitness had sufficiently identified the information it relied on and the information it now believed to be false.

These cases demonstrate that Franchisees can survive motions to dismiss and motions for summary judgment if they can sufficiently demonstrate reasonable reliance and point to specific documents. However, as the following cases demonstrate, success on fraud and misrepresentation claims can be difficult for Franchisees.

---

<sup>66</sup> *Functional HIIT Fitness, LLC v. F45 Training Incorporated*, No. 5:22-CV10168, 2022 WL 17828930 (E.D. Mich. Oct. 26, 2022).

A case in which the plaintiff was not able to establish a reasonable basis for a claim of fraudulent inducement is *Real Estate Visionaries, Inc. v. Re/Max of New England, Inc.*<sup>67</sup> In this case, Leading Edge, the Franchisee, signed a franchise agreement with Re/Max to operate a real estate franchise business.

Following a tumultuous end to the relationship, Real Estate Visionaries brought legal action against Re/Max. One of the main aspects of the lawsuit was a claim that Re/Max had fraudulently induced Real Estate Visionaries into signing franchise agreements. Specifically, Leading Edge argued that Re/Max misrepresented its policy, discussed in Item 17 of the FDD, regarding the expiration dates of franchise agreements and its practice of offering longer terms to multi-unit Franchisees. Re/Max, according to Leading Edge, insisted on staggered expiration dates to make it harder for Franchisees to leave without violating non-compete clauses.

The court found that Leading Edge could not demonstrate reasonable reliance on these alleged misrepresentations. The use of the word "may" in Re/Max's franchise disclosure document (FDD) regarding term extensions indicated that such extensions were not guaranteed, undermining Leading Edge's claim. Furthermore, the court noted that Leading Edge, as a sophisticated party, had signed agreements with staggered durations, suggesting they could not show actual reliance or causation regarding the misrepresentations. Consequently, the court dismissed Leading Edge's fraudulent inducement claim, highlighting the importance of reasonable reliance in such cases. Specifically, courts appear hesitant to conclude a plaintiff reasonably relied on a representation in cases where a specific action was not explicitly guaranteed under the language of the agreement. Courts are even more critical of fraudulent inducement claims in cases where the Franchisee is experienced or sophisticated.

Another case in which the Franchisee could not establish sufficient grounds for fraud was *Mount Holly Kickboxing, LLC v. FranChoice, Inc.*<sup>68</sup> In this case, the defendant, FranChoice, Inc. ("FranChoice"), was a Third Party Franchise Seller for the Franchisor of the iLoveKickboxing.com system ("ILKB"). Mount Holly Kickboxing, LLC ("Mount Holly") was formed by plaintiff Dhyhan Tarver ("Tarver") to operate an ILKB studio under a franchise agreement Tarver executed with ILKB in his individual capacity.

The plaintiffs alleged that FranChoice had made several misrepresentations during the sales process, which induced Traver to enter into the agreement. The plaintiffs referenced four primary misrepresentations: (1) that the ILKB franchise required little or no hands-on involvement by the studio owner and was suitable for absentee ownership; (2) that it would only cost Tarver \$275,000 to start an ILKB franchise; (3) that there were no struggling ILKB Franchisees; and (4) that no ILKB franchises had ever closed.

The Court in this case ultimately found that only one of these statements (that no ILKB franchises had ever closed) constituted an actionable misrepresentation as a "false representation of past or existing fact." For the other three statements, there was not sufficient evidence of falsity. The Court clarifies that "statements of puffery" do not constitute the basis for a fraud claim.

For the remaining actionable statement regarding the claim that no ILKB franchises had closed, the Court determined that Tarver had not reasonably relied on the statement. In support of its

---

<sup>67</sup> *Real Estate Visionaries, Inc. v. Re/Max of New England, Inc.*, No. 1881CV01676, Bus. Franchise Guide (CCH) 16642 (Mass. Super. Ct. Apr. 16, 2020).

<sup>68</sup> *Mount Holly Kickboxing, LLC v. Franchoice, Inc.*, No. CV 19-300 (MJD/ECW), 2021 WL 1117968, at \*13 (D. Minn. Mar. 24, 2021).

determination, the Court pointed out that Tarver had reviewed the FDD and other applicable documents, which explicitly contradicted the claim that no franchises had ever closed. The Court also pointed to Tarver's education and experience. He had received a college degree and also ran his own real estate business. Between his education and the fact that he had reviewed the FDD and other documents, the Court found that Tarver could not claim that he reasonably relied upon the Franchisor's statement that no ILKB franchises had ever closed. The plaintiff's case was dismissed with prejudice. This case demonstrates the importance of considering whether statements are actionable and evaluating whether there was reasonable reliance when bringing claims for fraud.

The following case emphasizes the need for Franchisees to review all relevant franchise documents carefully, and how failing to do so can undermine future claims relating to fraud. In *Trident Atlanta LLC v. Charlie Graingers Franchising LLC*<sup>69</sup>, the Franchisees sued the Franchisor, Charlie Graingers, and its owners for fraud, negligent misrepresentation, violations of the North Carolina Unfair and Deceptive Trade Practices Act (UDTPA), breach of contract, and breach of fiduciary duty.

The Franchisees claimed they were induced to enter franchise agreements based on misrepresentations in the Franchise Disclosure Document (FDD) and additional written representations outside the FDD. These misrepresentations included exaggerated claims about the resources and operational support provided by Charlie Graingers and assurances of success due to the franchise being a "low cost-low overhead foolproof restaurant concept."

The court granted the individual defendants' motion for summary judgment and denied the Franchisees' corresponding motion. The court found that the individual defendants were entitled to summary judgment on the fraud, negligent misrepresentation, and UDTPA claims because critical decision-makers for the Franchisees did not rely on, and in many cases did not even receive or review, the documents containing the alleged misrepresentations. The court also ruled that even if the decision-makers had reviewed these documents, their reliance would not have been reasonable due to contradictions with the franchise agreements' terms, which limited the scope of assistance and support from Charlie Graingers. Additionally, the court deemed some of the alleged misrepresentations as mere puffery, not actionable under the law. This case further illustrates the high bar that needs to be met to establish reasonable reliance on statements, whether those statements are made verbally, within the FDD or franchise agreement, or in any other document.<sup>70</sup>

As seen in these cases, Franchisees often have difficulty with claims involving fraudulent misrepresentation or fraudulent inducement. One of the biggest challenges for Franchisees seeking to recover under these causes of action is establishing reasonable reliance. In numerous other cases, Franchisee fraud claims were frustrated by a lack of reasonable reliance.

## **B. Non-Disclosure**

In addition to misrepresenting important information, actions can arise against Franchisors for omission of specific information concerning the franchise relationship. An example of this can be found in *Lunt v. Frost Shades Franchising, LLC*.<sup>71</sup> In this case, the Franchisee signed a franchise agreement to

---

<sup>69</sup> See *MTR Capital, LLC v. LaVida Massage Franchise Development, Inc.*, Case No. 17-CV-13552, 2020 WL 6536954 (E.D. Mich. Nov. 6, 2020); *K.C. Co. v. Pella Corp.*, No. DKC 20-0227, 2021 WL 288195 (D. Md. Jan. 28, 2021).

<sup>70</sup> *Trident Atlanta LLC v. Charlie Graingers Franchising LLC*, Case No. 7:18CV-10, 2020 WL 6889208 (E.D.N.C. Nov. 23, 2020).

<sup>71</sup> *Lunt v. Frost Shades Franchising, LLC*, No. 3:22-cv-00775, 2023 WL 3484202 (M.D. Tenn. May 16, 2023).

operate a franchised business that sells and installs window tints and applies window films. Lunt later claimed that in addition to the Franchisor failing to provide him with an operations manual or the requisite training needed to run the business, the FDD he was provided had deficiencies under Item 3.

Lunt later claimed that in addition to Frost Shades having never provided an operations manual or sufficient training, the FDD was deficient as it related to Item 3. Specifically, two of Frost Shades' owners (Goldberg and Swanson) were previously involved with another Franchisor (Patch Boys Franchising), which was subject to multiple actions, including an investigation by the Minnesota Department of Commerce. One of the owners had also been subject to an investigation by the Attorney General of New York, resulting in the assurance of discontinuance whereby the Franchisor and Goldberg acknowledged they had failed to disclose a conviction for credit card fraud.

Despite all of this, the Franchisor's FDD stated: "No litigation is required to be disclosed in this Item." Lunt brought claims for fraudulent inducement, fraudulent concealment, fraudulent misrepresentation, restitution, rescission, and an injunction prohibiting Frost Shades from enforcing its non-compete.

The Court ultimately determined that Lunt had demonstrated a likelihood of success on the merits of the fraud claim because the prior actions involving the franchise owners' previous franchise likely should have been disclosed, which supports an "inference that the defendants were aware that they had improperly omitted items from the FDD and that they committed those omissions for the purpose of inducing Lunt's reliance."

Franchisees seeking to bring actions against Franchisors for fraud or disclosure violations should be aware of the requirements for each action they bring. The most recent case law has demonstrated that success is far from guaranteed on these claims, particularly in cases where the Franchisee fails to cite specific documents or statements supporting their claims.

## **IX. FTC rulemaking process and amendments to the Franchise Rule**

The federal government's role in regulating the franchising industry dates back to 1979 when the original "Federal Trade Commission Franchise Rule" was passed. Since then, the FTC has reviewed the rule every ten years.

Like other administrative agencies, the FTC follows a relatively structured rulemaking process when proposing potential amendments to the Amended Rule. In 2019, the FTC announced a regulatory reviewed project, referred to the commission as the "2019 FTC Franchise Rule Review." As discussed in Section II, one of the major questions for which the FTC sought input from industry members was whether the Amended Rule should be modified. Comments on the questions raised by the FTC were due to be submitted in May of 2019.<sup>72</sup>

Despite a relatively consistently structured review process, the path from soliciting input from industry members to making substantive changes to the rule has proven slow-moving. A similar regulatory review to the one introduced in 2019 was conducted in 1995. While the feedback received during that

---

<sup>72</sup> FED. TRADE COMM'N, *FTC Seeks Public Comment as Part of its Review of the Franchise Rule*, <https://www.ftc.gov/news-events/news/press-releases/2019/02/ftc-seeks-public-comment-part-its-review-franchise-rule>

review did lead to substantive changes in what is now the Amended Rule, these changes were not put forth in an official rule until 2007, with the actual updates going into effect in 2008.<sup>73</sup>

Given the extensive timelines for previous regulatory changes, it's unsurprising that following the initial request for input, no major announcements were made by the FTC for several years.

The next significant development in the FTC's franchise relegation activity came in March of 2023 with the issuance of the RFI. This RFI sought input on various topics, most centered around the balance of power within the franchise relationship.<sup>74</sup> Comments for this RFI were due on June 8, 2023. There is no indication that this RFI is directly related to the 2019 Regulatory Review. However, the RFI could signal future FTC activity in the franchising space.

Outside of the FTC's standard procedures for soliciting input and proposing rules, industry members also have the option to submit a "Petition for Rulemaking." These petitions allow individuals, businesses, or other organizations to submit proposed changes that they believe would benefit the applicable industry. In 2021, the FTC voted to approve several changes designed to make it easier for the public to petition the agency for rulemaking.<sup>75</sup> Amongst the notable changes to the process were the addition of a requirement that the FTC publish all petitions it receives and that each petitioner be provided with a point of contact within the FTC.<sup>76</sup>

If and when the FTC will release a proposed rule based on the feedback it has received from the 2019 and 2023 public comment periods is unknown at this time. As of the submission of this paper, no proposed rule has been announced.

While the FTC has solicited input from franchise industry members multiple times, it has yet to signal plans to issue proposed changes to the Amended Rule. If a Notice of Proposed Rulemaking is announced, it will be subject to a mandatory notice and comment period, in which the public can submit their thoughts on the proposed changes.<sup>77</sup> Following that period, the FTC will review and consider the input received from the public as well as conducting other analyses of costs of compliance and impact to small businesses required under the Magnuson Moss Act. Upon satisfying its rulemaking requirements, the FTC may publish its final rule to the Federal Register.

## **X. Article 11 Working Group Recommendations for Changes to the FDD**

### **A. Recommended Non-Substantive Changes to the FDD**

For the most part, the Article 11 Working Group sought to work within the existing framework of the current requirements for the FDD. To be clear, the intent of the Group is not to reduce or eliminate pre-sale information that prospective Franchisees enjoy today, but rather, to increase the readability of

---

<sup>73</sup> 84 Fed. Reg. 9,051 (Mar. 13, 2019).

<sup>74</sup> FED. TRADE COMM'N, *Solicitation for Public Comments on Provisions of Franchise Agreements and Franchisor Business Practices*, [https://www.ftc.gov/system/files/ftc\\_gov/pdf/Franchise-RFI.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/Franchise-RFI.pdf)

<sup>75</sup> FED. TRADE COMM'N, *FTC Opens Rulemaking Petition Process, Promoting Public Participation and Accountability*, <https://www.ftc.gov/news-events/news/press-releases/2021/09/ftc-opens-rulemaking-petition-process-promoting-public-participation-accountability>

<sup>76</sup> *Id.*

<sup>77</sup> FED. TRADE COMM'N, *Public Participation in the Rulemaking Process*, <https://www.ftc.gov/enforcement/rulemaking/public-participation-rulemaking-process>

the FDD and make the information presented more readily understood. This is accomplished by a series of recommended changes that predominately changes the style and organization of the FDD. These changes are, in large part, designed to modernize restrictions on the design of the FDD that have been in place for decades and do not take into account how the modern Franchisee takes on information in the age of social media, internet search engines and Artificial Intelligence.

## **1. Enhance the use of Navigational Tools**

One example of such a restriction is the requirement that FDDs be presented as a single document that is downloadable. It may not be presented in multiple, discrete parts. For example, “a Franchisor may not list lawsuits in Item 3 and then provide a link to external documents that explains the suits in greater detail.”<sup>78</sup> Further, disclosures made via electronic media must be identical to documents furnished in “hard copy”.<sup>79</sup> In an age where the use of hyperlinks is a daily occurrence for most of the investing public, prohibiting hyperlinks outside of the four corners of the FDD seems like an outdated restriction.<sup>80</sup> One assumes that the reason for this rule is a concern that a Franchisee will not link to a second site. Now that we have gone beyond the manual paper transmissions of FDDs, with e-disclosure and the electronic transmission of FDDs widely done, it seems a convenience that interested Franchisees will link to, if they so desire. The advantage of the external hyperlink is to enhance the readability of the FDDs by removing pages of unnecessary text to one discrete place by reducing the volume of pages Franchisees need to wade through in a sea of a regulatory document that is hundreds of pages. Hilton’s FDD for its Hampton brand is over 500 pages, with dozens of those pages reciting page after page of all 2,700 plus Franchisees in the Hampton system. Would it not make sense to reduce the FDD by those dozens of pages and allow the prospective Franchisee to point and click at this information at will? This author suggests that much of the materials contained in the exhibits to the FDD would be well placed via a hyperlink, with the possible exception of the form franchise agreement, and arguably, the Franchisor’s financial statements.

To the extent that retaining the ability to print the FDD in book form is desirable, it is possible to retain the option to download the FDD in a book format. The FTC currently uses a “point and click” approach when presenting the FTC Rule. The “publish” button enables the Franchisee to click on a PDF of the FDD if that is desirable. This could be behind a secure link on the Franchisor’s website. A screenshot of how the FTC site looks is attached hereto as Exhibit 1.

## **2. Permit the use of alternate forms of media**

The Amended Rule prohibits the use of electronic features in a FDD, such as audio, video, animation, pop-up screens, or, as just discussed, links to external information outside of the disclosure document.<sup>81</sup> There are various concerns with the use of alternate media in FDDs. First, it is inconsistent with the idea that FDDs should be rigidly standardized in form and content. Prohibiting alternate media promotes consistency across offerings. Second, introducing electronic content could introduce variability

---

<sup>78</sup> Franchise Rule Compliance Guide p. 121 (2008)

<sup>79</sup> *Id.* at 122.

<sup>80</sup> The Amended Rule does permit some non-substantive navigational tools such as scroll bars and internal links – such as those linking the table of contents to each specific disclosure item – and search features. It also permits minor non-substantive links to external features that aid a prospective Franchisee’s review of the document, such as a link to AdobeTM, from which prospective Franchisees can download Adobe Reader. A Franchisor may also link the cover page reference to the Consumer Guide to Buying a Franchise with the appropriate link on the FTC’s website. *Id.* at 123.

<sup>81</sup> *Id.*

in the information presented or reviewed by Franchisees. Prohibiting such content arguably provides a level playing field between competing Franchisees.

However, permitting the use of alternate media in FDDs is increasing likely to be consumed by the “tik-tok” generation and offers several benefits to prospective Franchisees. An individual can focus their attention on a screen for approximately 47 seconds.<sup>82</sup> First, video bursts, pop-ups, animated cartoons or interactive quizzes or platforms are more engaging than a text document. By making the FDD more engaging, we increase the likelihood that prospective Franchisees will consume more information that will enhance their buying decision. Multimedia presentations are also likely to be presented in a manner that is more understandable, increasing a prospective Franchisee’s understanding of the terms and conditions of the franchise agreement, the franchise industry and the overall operation of the franchise system. Removing the restriction on alternate media will result in more effective communication with the Franchisee community than retaining the current standard.

### 3. Increase document accessibility for Franchisees

The Amended Rule embraced the idea of having the FDDs drafted in “plain English”.<sup>83</sup> Yet the FTC still requires certain sections to be in bold print, words in all capital letters and/or underlined, or in a table format, none of which is ideal from a plain English accessibility standpoint.

These requirements are generally required to highlight important information in the FDD. They do, however, present challenges for individuals with visual or reading impairments making it difficult to fully comprehend the information presented, simply because of the way it is presented. Assistive technologies such as screen readers or magnification software frequently will not properly work with bold, fully capitalized or underlined text. Such conventions can also be challenging for those whose native language is not English.

This author recommends that the FDD be designed with accessibility in mind, eliminating large font sizes, words in all capital letters, underlining and any other convention that emphasizes and distracts from the text. Other suggestions would be to permit the use of visual aids, such as charts and graphs in a color format, rather than preordained tables. These changes comport with the requirements of Section 508 of the Rehabilitation Act of 1973, as amended (29 U.S.C. § 794d), which requires all electronic and information technology that is “developed, procured, maintained, or used by a federal agency to be accessible to people with disabilities”.<sup>84</sup> It further comports with the FTC’s stated commitment to make:

[i]nformation and communications technologies delivered through its Internet site accessible for all members of the public, including individuals with disabilities. In the spirit of this commitment, the FTC strives to “provide information and communication technology that meets or exceeds the compliance requirements of Section 508. To meet this commitment, our website, FTC.gov includes several features designed to improve accessibility for users with disabilities. Some of the images on the site contain “alt tags,” which aid users who listen to the content of the site by using a screen reader, rather than reading the site. Likewise, a “skip to” link provides these users with a method for bypassing the header and going directly to the main content each time a page is

---

<sup>82</sup> Sandee LaMotte, *Your attention span is shrinking, studies say. Here’s how to stay focused*, CNN (May 30 2023), <https://www.cnn.com/2023/01/11/health/short-attention-span-wellness/index.html>.

<sup>83</sup> *Id.* at 121.

<sup>84</sup> 29 U.S.C. § 794d (1973), as amended.

accessed. In addition to the features that make the graphics version of the site more accessible, a text-only version provides added convenience for users.

Now is also the time to be forward thinking about current AI technologies and the role they are likely to play in FDD review going forward. Anecdotal evidence suggests that Franchisors are already using ChatGPT to compare and contrast the FDDs of their competitors in easy to read tabular and chart formats. The FTC should consider the utility of AI plug-ins and other technology solutions (whether existing or later developed) related to disclosure requirements.

#### **4. Reimagining the format of the FDD**

##### **a) Introducing an Executive Summary**

The idea to present Franchisees with a summary of the franchise document is not new. In 2016, Eric Karp and Ari N. Stern proposed the use of a mandatory summary franchise disclosure document to empower potential Franchisees to make an educated investment decisions before the franchise sale.<sup>85</sup>

In their article, Karp and Stern note that over time, the length and complexity of the FDD has grown and that the sheer amount of information contained in a typical FDD makes it “impenetrable and intimidating to most potential Franchisees”.<sup>86</sup> Karp and Stern further posit that “Franchisees have difficulty making well-informed decisions” and that the current format of the FDD is cumbersome, filled with legalese and makes “the presentation of information convoluted.”<sup>87</sup> They further note that many Franchisees are inexperienced in business and “believe that the way to minimize the risk of failure is to work with a Franchisor who will provide a reputable system, strategic counsel, detailed operations plans, continuous advice, and training for success.” By virtue of their inexperience, Franchisees do not work to digest the FDD or otherwise investigate the franchise system nor do they typically hire legal counsel to advise them prior to the purchase of the franchise.<sup>88</sup>

Of course, support for a mandatory summary disclosure document is not universal. In *A Proposed Mandatory Summary Franchise Disclosure Document, A Solution in Search of a Problem*, the authors opposed the idea of a mandatory summary document in large part because Karp and Stern’s proposal created new mandatory disclosures not required under the Amended Rule<sup>89</sup>. The authors’ view was that the nature of franchise disclosure had changed since the Franchise Rule was first promulgated, and that Franchisee had access to varied forms of information relating to franchising. There was also some scepticism that changing the form of the FDD would be impactful if Franchisees were not willing to do the work necessary to understand the FDD prior to purchasing a franchise.<sup>90</sup> Overall, their view was that introducing a summary disclosure document would create unnecessary burdens for Franchisors without significantly benefiting Franchisees.

On balance, the Article 11 Working Group does think that a summary of the FDD, without creating additional disclosures not already required by the Amended Rule or that could be gleaned from

---

<sup>85</sup> Eric H. Karp and Ari N. Stern, *A Proposal for a Mandatory Summary Franchise Disclosure Document*, FRANCHISE LAW JOURNAL • Vol. 35, No. 4 • Spring 2016 pp. 541-575.

<sup>86</sup> *Id.* At 543.

<sup>87</sup> *Id.* At 548.

<sup>88</sup> *Id.* At pp 548-549.

<sup>89</sup> Carl E. Zwisler, John J. McNutt, Frank J. Sciremammano, *A Proposed Mandatory Summary Franchise Disclosure Document A Solution in Search of a Problem*, FRANCHISE LAW JOURNAL, Vol. 36, No. 3 (Winter 2017), pp. 465-490

<sup>90</sup> *Id.* At 467

an examination of the FDD, would enhance the Franchisee’s understanding of the information presented, thereby advancing the purpose of the disclosure. As discussed during the FTC 2020 workshop, the executive summary will be designed to provide a roadmap for the Franchisee to assist in navigating the FDD, allowing a prospective Franchisee to easily compare offerings. Examples of these disclosures include, in part, the number of Franchisees in the system, whether the system was increasing or decreasing in size, a litigation disclosure, information relating to the fees, the marketing fund, basic franchise agreement terms, term and renewal rights, transfer and termination rights, liquidated damages obligations, non-compete requirements and dispute resolution, all in a simplified form. An example of potential fields for disclosure in the executive summary is contained in Exhibit 2.

#### b) **Reorganizing the FDD**

The Article 11 Working Group has considered the information in the FDD presented from a prospective Franchisee standpoint and adopted a series of recommendations that presents the information in a logical way, with the information the Franchisee really wants to know (primarily economic information) presented first. These sets of recommendations are not designed to change the substantive content of the FDD, but simple repackaging it.

The revised FDD would be presented in a Q&A style disclosure in place of the current structure of 23 Items. These questions include:

- What is the franchise?
- How much does it cost?
- How much can I make?
- Is Franchisor financing available?
- If I become a Franchisee, what are your obligations to me?
- If I become a Franchisee, what are my obligations to you?
- How does the Franchise System operates?
- What Intellectual Property do you own and what are your Technology requirements?
- Who are your Franchisees?
- What happens if I want to leave the system?
- About us (all presented via embedded links)
- Additional Information (embedded links)
- Receipts

#### 1. **What is the Franchise?**

This section is the information contained in Item 1 (The Franchisor, Its Parents, Predecessors, and Affiliates)<sup>91</sup> that relates to the disclosure requirement about the nature of the franchised business and the franchise being offered, i.e., what is the Franchisor selling?<sup>92</sup> Other parts of Item 1 relating to corporate information about the Franchisor, its parents, predecessors and affiliates,<sup>93</sup> are moved to the “About us” section.

---

<sup>91</sup> 16 C.F.R. §436.5(a)

<sup>92</sup> 16 C.F.R. §436.5 (a)(3) and (6)

<sup>93</sup> 16 C.F.R. §436.5 (a)(1), (2), (4), (5) and (7)

## 2. How much does it cost?

The disclosure for information contained in Items 5 (Initial Franchise Fee)<sup>94</sup>, 6 (Recurring or Occasional Fees)<sup>95</sup> and 7 (Estimated Initial Investment)<sup>96</sup> has been moved to the beginning of the FDD, given that these Items are the heart of the disclosure to a Franchisee and contain the information that they are most likely to be interested in. The contents of these Items are uncontroversial and easy for a Franchisor to comply with. However, the cost and fee information associated with the franchise offering set out in several Items in the FDD (Items 5, 6, 7, 8 (Restrictions on Source of Products and Services)<sup>97</sup> and 11 (Franchisor's Assistance, Advertising, Computer Systems and Training)<sup>98</sup>) based on either when the cost is paid, who it is being paid to, and/or by what the subject of the payment is. This requires the prospective Franchisee to piece together information from various parts of the FDD to determine the entire cost of the franchise.

In order to determine all required "initial" fees that must be paid to the Franchisor or affiliates prior to opening, the prospective Franchisee must review Item 5. To determine all required "initial" fees and costs that must be paid to third parties before opening, the prospective Franchisee must review Items 7 and 11. Examples of these fees include application fees, renovation/improvement plan fees, computer system costs, and other miscellaneous fees. Because Item 5 requires all fees payable to the Franchisor prior to opening be listed, the list can be long. The initial fees listed in Item 5 are largely duplicative of information contained in Item 7, and to the extent they are not, they are easily added to Item 7, which requires Franchisors to set out the estimated initial investment necessary for a prospective Franchisee to commence business.

In addition to being duplicative, Item 5 can be confusing when a portion of an initial start-up cost is paid to the Franchisor and a portion is paid to third parties, which is now common for computer technology and other business elements – because the whole cost is not presented up front. Only a portion of the cost is presented in Item 5. In the computer system example, the reader must read all the way through Items 5, 7, 8, and 11 to understand the entire initial computer system and which components must be acquired from and paid to the Franchisor (like the Franchisor's proprietary software), and which must be acquired from and paid to third parties (like antivirus software). Eliminating Item 5 and placing all costs for the computer system together in one place (all hardware and all software) in the revised Item 7 solves this problem. Several countries don't have an Item 5 and only have an Item 7, and a combined disclosure seems to work well in those markets.

With respect to Item 6, many of these recurring or occasional fees relate to ongoing computer system fees, advertising, and training are also disclosed Item 11. Fees for considering alternate suppliers are disclosed in Item 8. To the extent the fees listed in Items 8 or 11 recur or arise occasionally, they could be moved to Item 6 and the one-time pre-opening costs could be moved to Item 7. This would enable all amounts to be removed from Items 8 and 11.

In short, the Article 11 Working Group recommends combining all initial fees and costs reflected in Items 5, 6, 7, 8 and 11 into one place and all recurring fees, as currently set forth in Items 6, 8 and 11 in a second place, both under this question, for clarity and simplicity.

---

<sup>94</sup> 16 C.F.R. §436.5(e)

<sup>95</sup> 16 C.F.R. §436.5(f)

<sup>96</sup> 16 C.F.R. §436.5(g)

<sup>97</sup> 16 C.F.R. §436.5(h)

<sup>98</sup> 16 C.F.R. §436.5(k)

### 3. How much will I make?

One of the most contentious issues in franchising is the mandating of Financial Performance Issues in Item 19.<sup>99</sup> It is not surprising that this topic resulted in spirited debate amongst the Group. In the end, the Article 11 Working Group was aligned in the belief that attempting to impose that as a mandatory Item 19 (which would obviously be a material change to the Amended Rule) would delay us being able to deliver proposed amendments to the FTC staff because the questions raised during the FTC 2020 workshop around how to craft a regulatory requirement that applies across all industries remain unanswered.

The Article 11 Working Group does think the franchise community should explore improvements to the existing disclosure requirements to allow brands the ability to provide adequate disclosures to prospective Franchisees, being mindful of the concerns relating to the use of disclaimers. The Article 11 Working Group is aligned with the panelists in the FTC 2020 workshop that support adoption of the FPR Commentary and is also looking at clarifying revisions to FPR Commentary<sup>100</sup>. The only immediate non-substantive change to Item 19 is to move this to the front of the FDD.

### 4. Is Franchisor financing available?

This section encompasses Item 10 (Financing).<sup>101</sup>

### 5. If I become a Franchisee, what are your obligations to me?

This section covers Item 11 as it relates to Franchisor Assistance. As indicated earlier, we would eliminate information relating to computer systems and related costs from this part of the disclosure, since we have already dealt with that information in earlier sections. The focus here is on the actual obligations the Franchisor is undertaking to the Franchisee. These include Franchisor obligations, if any, regarding site selection, developing products or services to be offered by the Franchisee, hiring and training of Franchisee's employees, price setting, advertising and marketing, and matters relating to advisory council and cooperative associations.<sup>102</sup> Typically Franchisors have a section of their franchise agreement that expressly states the obligations the Franchisor is undertaking to the Franchisee. This section would seek to have those obligations moved to the front and center of the disclosure.

### 6. If I become a Franchisee, what are my obligations to you?

This section would replace the current Item 9 (Franchisee Obligations)<sup>103</sup> by deleting the table of twenty-six predetermined obligations with cross references to the franchise agreement and have the Franchisor actually list out the obligations set forth in the franchise agreement. This would be done in a narrative format, so there is a discussion of each individual obligation rather than simply a list of obligations with cross references which requires the Franchisee to review the franchise agreement in tandem with the FDD.

---

<sup>99</sup> *Supra* n. 39.

<sup>100</sup> *Id.*

<sup>101</sup> 16 C.F.R. §436.5(j)

<sup>102</sup> 16 C.F.R. §436.5(k)(1)-(4)

<sup>103</sup> 16 C.F.R. § 436.5(i)

## 7. How does the Franchise system operates?

This section would focus on the heart of how the Franchise System operates. This is where the Franchisor would disclose the Franchisees' obligation to purchase or lease goods related to establishing or operating the franchised business from any source and any restrictions on those sources as disclosed in Item 8. The Franchisor's training program, currently set forth in Item 11 would be disclosed here. The disclosure for Item 12<sup>104</sup> relating to the Franchisee's territory, if any, rules around relocation and the establishment of company operated units as well as any restrictions what the Franchisee may sell as set forth in Item 16 (Restrictions on What the Franchisee May Sell).<sup>105</sup> The disclosure relating to Franchisor's advertising and marketing funds, as well as the Table of Contents, which could be a hyperlinked, would be set forth here.

## 8. What Intellectual Property do you own and what are your Technology requirements?

This section will pull all the elements of the FDD that relate to Technology and Intellectual Property and put them into one coherent section. It is primarily comprised of the disclosure required in Item 11, Item 13 (Trademarks)<sup>106</sup> and Item 14 (Patents, copyright and computer systems)<sup>107</sup>.

## 9. Who are your Franchisees?

This section will contain the information currently contained in the Item 20 (Outlets and Franchisee Information)<sup>108</sup> charts relating to outlets and franchise information detailing franchise system growth and turnover in an easily understandable and concise format. This section will also contain hyperlinks to the exhibits that sets forth the Franchisor's list of current franchised hotels and list of terminated hotels.

The Article 11 Working Group concluded that there is an opportunity to clarify the current disclosures in this area, including an introductory paragraph explaining what information the charts convey. Adding definitions "transfers" and "termination of default" would also add clarity to this section.

The Article 11 Working Group also recommends revising the columns in Tables 2-5 to more accurately describe the information conveyed. For example, replace Table 2 with a statement that reflects systemwide transfers by year for the Franchisor's last 3 fiscal years. In Table 3, revise the columns to further state: "Outlets at Start of Year," "Company Owned Outlets," "Franchised Outlets," "Terminations for Default," "Exited for Other Reasons," "Outlets at the End of the Year." Finally, consider removing Tables 4 and 5 and replace them with: (1) Franchise Agreements sold but not open; (2) % of Franchise Agreement signed before the last fiscal year; (3) Development Units sold but not open; and (4) % of Development Units not in compliance with development schedule. In addition, disclose Franchisor's % of revenue during last fiscal year derived from: (1) initial fees; (2) continuing fees; (3) payments from third parties related to Franchisee's purchases/leases (insert link to "About Us" section for financial disclosures).

---

<sup>104</sup>

<sup>105</sup> 16 C.F.R. §436.5(p)

<sup>106</sup> 16 C.F.R. §436.5(m)

<sup>107</sup> 16 C.F.R. §436.5(n)

<sup>108</sup>

## 10. What happens if I want to leave the system?

The Article 11 Working Group proposes to eliminate the Item 17 (Renewal, Termination, Transfer, and Dispute Resolution)<sup>109</sup> chart completely with a simple explanation of the renewal, termination, transfer, dispute resolution and liquidated damages provisions.

## 11. About us

This section relates to corporate information about the Franchisor that used to be front and center of the FDD, but now will be accessed through hyperlinks for the convenience of the Franchisee. These hyperlinks will include all corporate information contained in Item 1<sup>110</sup>, Item 2 (Business Experience),<sup>111</sup> Item 3 (Litigation),<sup>112</sup> Item 4 (Bankruptcy),<sup>113</sup> Item 21 (Financial Statements),<sup>114</sup> and Item 22 (Contracts).<sup>115</sup>

## 12. Additional Information

This section would contain required exhibits not specific to the Franchisor, such as State Administrators and Agent for Service of Process.

## 13. Receipts

The FDD would close, as it does today, with the Receipts.

### B. Recommended Substantive Changes to The FDD

#### 1. Recommended Additions to the Required Disclosures

##### a) Disclosure Related to System Standard Changes

One of the most hotly debated issues in the franchise community is the Franchisor's ability to implement changes to the franchise system through the brand standards manual, often imposing significant costs for Franchisees post-contract execution. One question the Article 11 Working Group considered is how Franchisors could provide information to prospective Franchisees about the system changes they may expect and capital investments that may be required without stifling innovation and flexibility needed for the franchise system to remain competitive in its industry and avoid disclosure of a Franchisor's confidential and proprietary information about planned upgrades to competitors.

One possible approach is to consider disclosure related to current year initiatives (for example, a section where the company lists system initiatives that are being implemented including remodel, technology improvements, etc.). After consideration, the Article 11 Working Group concluded that this approach would unduly limit a Franchisor's ability to respond to changes in the business environment and would effectively require Franchisors to provide a year's advance notice of major system changes. In the

---

<sup>109</sup>16 C.F.R. § 436.5(q)

<sup>110</sup> 16 C.F.R. §436.5(a)(1), (2), (4), (5) and (7).

<sup>111</sup> 16 C.F.R. §436.5(b)

<sup>112</sup> 16 C.F.R. §436.5(c)

<sup>113</sup> 16 C.F.R. §436.5(d)

<sup>114</sup> 16 C.F.R. §436.5(u)

<sup>115</sup> 16 C.F.R. §436.5(v)

alternative, the FDD could include disclosures that make clear to a prospective Franchisee whether significant additional investments may be required during the initial three years or final three years of the franchise term, or the frequency within which a Franchisor may require significant remodels (i.e. a remodel or upgrade exceeding 25% of the initial investment). This could be coupled with a disclosure to Franchisees that a short-term extension of the existing franchise term may or may not be available for completing system changes and upgrades.

The Article 11 working Group also considered the question of what considerations should be made for underperforming units and units with short-term leases in relation to system standard changes. The group agreed that as a practical matter, a Franchisor needs to consider alternative approaches for underperforming units and units with short lease terms when considering large capital investments and that where a Franchisee has less than three years remaining on its lease and is unable to renew, Franchisors should consider reduced investment in system changes. However, the Article 11 Working Group stopped short of recommending an express disclosure obligation around this issue.

Finally, the Article 11 Working Group considered whether Franchisors should be required to demonstrate how system changes are evaluated prior to implementation in the franchise system. While testing in company-owned units prior to rollout to Franchisees can be helpful in gaining Franchisee buy-in, not all Franchisors have company operated units? Again, the Article 11 Working group refrained from making a recommendation for additional disclosure in this area.

#### **b) Disclosures Related to Supply Chain Issues**

The Article 11 Working Group has considered common franchise concerns relating to the Franchisor's supply chain. One common concern is the revenue received by a Franchisor or its affiliates related to required purchases of products or services from required or designated suppliers (which some Franchisee representatives have referred to as "undisclosed fees")<sup>116</sup>. A full section of the RFI was devoted to this issue, with reference to potential violations of the Robinson Patman Act prohibiting bribes and kickbacks. The Group considered existing supply chain management practices of Franchisors across industries and observed that while many Franchisors perform highly sophisticated supply chain optimization and management services on behalf of their Franchisees, a description of the services provided (even at a high level to protect the proprietary nature of a Franchisor's supply chain strategy) seldom appear in the FDD. A lack of information and communication breeds speculation. As Franchisees face increased supply chain costs with little communication or transparency, speculation that the Franchisor is raking additional revenue from Franchisee pockets seeps in. As the Group looked toward disclosure improvements to provide greater visibility into the benefits received by Franchisees of Franchisor-managed supply chain functions, one option would be to have a narrative description of how the Franchisor manages the supply chain for the franchise system ranging from types of supply chain functions that the Franchisor engages in (including transportation, warehousing and distribution), the work required, and costs associated with putting the functions in place including employees, how process compares to what is done for company-operated units, negotiations, approval of suppliers and continued oversight.

Another area of opportunity is greater transparency relating to what the Franchisor's margin or upcharge on produces are, given that the Amended Rule only requires that the Franchisor given a range

---

<sup>116</sup> *Insert cite to RFI responses.*

of payments due, without further context. Any changes in this area would appear in “How Does the Franchise System Operates”.

**c) Suggestions to Eliminate Certain Disclosures.**

The Article 11 Working Group largely refrained from actively removing current disclosure requirements, lest there be a disagreement within the franchise community on the utility of such disclosures. Yet there was general agreement around removing certain Items that are not expected to be controversial.

The first is the removal of “How to Use This Franchise Disclosure Document” which is replaced by the executive summary. Second, Item 18 (Public Figures)<sup>117</sup>, which requires the disclosure of paid endorsement of the franchise offering, is largely irrelevant and rarely utilized in modern FDDs. In the age of the Internet and celebrity influencer, it is questionable as to whether public figure endorsements impact franchise sales and simply makes an already long document longer. Finally, State Effective Dates, which indicate when the Franchisor's FDD has been registered in the registration states, is of no relevance to Franchisees and is an administrative burden for Franchisors to repeatedly having to update the text of the FDD as state registrations occur over the course of several weeks, if not months. It is the Franchisor's obligation to only sell franchises in jurisdictions as permitted by law and this particular disclosure has no utility.

**d) Third-Party Third Party Franchise Seller Disclosures**

Third Party Franchise Sellers facilitate the transaction between a potential Franchisee and the Franchisor. It is a crucial part of the franchise industry as it helps connect the right Franchisees with the appropriate Franchisors, ensuring a good fit for both the Franchisor and the Franchisee. However, as explained in detail below, in order to maintain transparency and trust in this process, there are several required disclosures that a Third Party Franchise Seller should be required to provide to prospective Franchisees.

**1. Types of Third Party Franchise Sellers**

Third Party Franchise Sellers are not all the same. In fact, there are various types and their level of involvement can be minimal by providing leads to Franchisor clients or more involved by providing a myriad of services on behalf of a Franchisor. The following are descriptions of the four types of third party franchise sellers that should be subject to franchise regulations:

**2. Individual Third Party Franchise Sellers:**

These are independent Third Party Franchise Sellers who work alone. They may represent a variety of franchise opportunities and offer personal, one-on-one advice to potential Franchisees. They make their money from the commission they receive when a deal is made between a Franchisor and a new Franchisee. Their main strength is their personalized service, but they may lack the extensive resources of larger organizations.

---

<sup>117</sup> 16 C.F.R. §436.5(r)

### 3. **Third Party Franchise Seller Networks:**

These are groups of Third Party Franchise Sellers who work together under a common brand or organization. They often have access to a wide range of franchise opportunities due to their collective reach. They can provide a more extensive service than individual third party franchise sellers, and they have the advantage of a larger network of contacts and resources. However, the advice they provide may not be as personalized as that from an individual third party franchise seller.

### 4. **Franchise Sales Organizations (“FSOs”):**

These are companies that specialize in marketing and selling franchises. They are contracted by the Franchisor to sell their franchise opportunities. They have a deep understanding of the specific franchises they represent and have extensive resources to market them effectively. They may have a wider range of franchises to offer, but their recommendations may be biased towards the franchises they represent. FSOs are highly effective at rapidly expanding a franchise concept.

### 5. **Franchise Consulting Firms:**

These are companies that primarily help small businesses become Franchisors. They will typically work with a founder who lacks the infrastructure or resources to develop a franchise system by providing supporting in all areas necessary for the creation, development and operation of a franchise system. Their services may even include franchise recruiting and sales, marketing, training, site selection, site development, and ongoing services including site visits, on-going training and consultation. These firms may even create the FDD for Franchisor.

#### a) **Current FTC Franchise Rule Disclosure Obligations for Third Party Franchise Sellers**

Under the current FTC Franchise Rule, Franchisors that use the services of Third Party Franchise Sellers may be required to identify the third party franchise seller or third party franchise seller network and make certain disclosures about the relationship with the third party franchise seller throughout the FDD. The FTC Franchise Rule defines as "franchise seller" as any person or entity who offers or arranges for the sale of an interest in a franchise. This includes the Franchisor, its employees, a subfranchisor, an agent, representative, independent contractor, or third-party third party franchise seller. Third-party Third Party Franchise Sellers, by definition, are “franchise sellers”. As a result, each third party franchise seller that communicates with the prospective Franchisee as an agent of the Franchisor should be identified on the Item 23 Receipt. But oftentimes the third party franchise seller is not identified on the Item 23 Receipt and even if he or she is identified, the disclosures are limited to the name, company affiliation, address and phone number, which may not be very helpful to the prospective Franchisee.

Item 2 of the FDD specifically requires the Franchisor to disclose the business experience of principal officers, directors and key personnel with management responsibility relating to the offer and sale of the franchises or the operation of the franchises. This item is intended to give prospective Franchisees information about the business acumen and experience of the people who are running the business.

As for third-party Third Party Franchise Sellers, whether or not they must be disclosed in Item 2 of the FDD can be a bit complex. If a third-party franchise seller is a third party franchise seller or agent representing the Franchisor, they would generally not be disclosed in Item 2 of the FDD. However, if the

third-party Third Party Franchise Seller, network, FSO or consultant has a role in management, either by overseeing the franchise recruitment and sales process or providing managerial functions over the operation of the franchises (e.g., overseeing training, site selection, onboarding, or other support), then their details would typically need to be disclosed in Item 2. By extension, if any of the third party franchise sellers disclosed in Item 2 of the FDD have pending or concluded litigation or administrative actions of the type required to be addressed in Item 3 of the FDD, then those matters would also need to be disclosed. Further, any bankruptcy history for a Third Party Franchise Seller identified in Item 2 must be disclosed in Item 4 of the FDD.

In addition to the Item 2, 3 and 4 disclosures, Franchisors might be required to disclose third party franchise sellers elsewhere in the FDD if the third party franchise seller provides additional services for Franchisees or the franchised business generally. For example, there are some third party franchise sellers networks that oversee training for Franchisees prior to, and even after, opening of the franchised business. If these third party franchise sellers are responsible for overseeing the training program, then they, or at least their experience with the Franchisor and in the industry, should be identified in Item 11 of the FDD.

While the FTC Franchise Rule does indeed have requirements for the identification of third-party third party franchise sellers throughout the FDD depending on its level of involvement in franchise sales and operations, compliance with these obligations can be inconsistent at best. In fact, most Franchisors and third party franchise sellers do not fully comply with these requirements. Moreover, even if they do comply with these obligations, the consensus amongst the stakeholders is that further regulation in this area would be helpful to prospective Franchisees. As a result, the industry is focusing on increased third party franchise seller disclosures going forward.

#### **b) Proposed Disclosure Requirements:**

The vast majority of franchise sales in the United States involve third party franchise sellers. Thus, some form of pre-sale disclosure regarding the third party franchise seller (and network) with whom the prospective Franchisee is working is necessary. In fact, the professional experience of the third party franchise seller, its relationship with the Franchisor and other franchised brands, the services it provides for the Franchisor, and how it is compensated is paramount and would be very helpful for the prospective Franchisee to know when it engages the third party franchise seller and relies on it throughout the franchise diligence and sales process.

The Working Group has recommended the following amendments to the FTC Franchise Rule to for third-party third party franchise sellers:

#### **1. Definition of Third Party Franchise Seller**

Tracking the definition of a “Third Party Franchise Seller” under Washington’s franchise laws, a “Third Party Franchise Seller” will be defined as *a person who directly or indirectly engages in the business of the offer or sale of franchises. A “Third Party Franchise Seller” does not include (i) a Franchisor, subFranchisor, area representative or their respective officers, directors or employees or employees of a wholly owned affiliate of the Franchisor or subFranchisor, or (ii) a Franchisee, unless the Franchisee is part of a Third Party Franchise Seller business.* For the sake of clarity, a “third party franchise seller” includes franchise sales organizations (FSOs), franchise consultants and any other third party engaged in franchise sales discussions with a prospective Franchisee except those expressly excluded in the definition above.

## 2. **General Disclosures Regarding Third Party Franchise Sellers**

The Article 11 Working Group does believe that it would be helpful to provide general information about Third Party Franchise Sellers and Franchisors by describing the different types of Third Party Franchise Sellers (e.g. individuals, third party franchise seller networks, franchise sales organizations, and outsourced franchise development along with sample questions for a prospect to ask a Third Party Franchise Seller and a summary of best practices for continuing education of third party franchise sellers.

## 3. **Third Party Franchise Seller Specific Disclosure Requirements**

Generally, the recommended disclosures for third-party third party franchise sellers fall into the following three categories:

### **Disclosures about the Third Party Franchise Seller**

These disclosures are required under the current FTC Franchise Rule and they include general information about the background of the third party franchise seller, including its credentials or professional experience for the past five years as well as any material litigation or bankruptcy history.

### **Disclosures about the Third Party Franchise Seller's relationships with other brands**

In this section of the disclosure document, the third party franchise seller would be required to disclose the industries that it represents and the number of brands within each industry (e.g., lodging, home services, quick service restaurants, etc.). The third party franchise seller would also be required to disclose the services it provides generally (including without limitation lead generation services, franchise sales marketing and advertising, prospective Franchisee interviews and other Franchisee due diligence, franchise discovery days, franchise system development strategy support and consulting, territory mapping, site selection, supplier selection, technology solutions licensing and support, and assistance preparing information to be included in the franchise disclosure document (for example, information presented in Items 7 and 19) and the ways in which the third party franchise seller may be compensated for those services (including, for example, commissions based on initial fees paid to the franchisor, a share of the continuing royalty revenue or equity in the franchisor).

### **Franchises Sold During the Prior Year**

Finally, the third party franchise seller should be required to disclose information regarding franchises sold during the prior year, including contact information for each Franchisee and the total units sold (including development rights). This allows prospective Franchisees to verify the third party franchise seller's track record and contact these Franchisees for references.

In essence, these disclosures ensure that the prospective Franchisee has all the necessary information to make an informed decision about engaging with a particular Third Party Franchise Seller. It promotes transparency, builds trust, contributes to a more efficient and effective franchise sales process and would benefit prospective Franchisees.

## II. **Conclusion**

Recognizing the challenges with the FTC’s rulemaking process, the time required to finalize any changes to the Amended Rule, and the need for immediate improvements to presale disclosures to ensure the franchise relationship commences on a strong foundation, creative solutions are needed. One possible solution may be through a staff advisory opinion issued by the FTC that permits franchisors to present the information currently required under the Amended Rule in a way that is more accessible and comprehensible to prospective franchisees, including a conversational style of disclosure with an executive summary, as described by the authors above. Other recommendations presented by the authors, including improvements to disclosures related to system standard changes and financial performance representations, require alignment by the franchise community and necessitate a rulemaking before they may be implemented through amendments to the Amended Rule. That said, there are immediate and impactful changes that all key stakeholders to franchising can make to strengthen the model, starting with increasing transparency and visibility in the franchise relationship by franchisors and franchisees for the betterment of the system.

**EXHIBIT 1**



Displaying title 16, up to date as of 4/26/2024. Title 16 was last amended 4/22/2024.

**Title 16 – Commercial Practices**  
**Chapter I – Federal Trade Commission**  
**Subchapter D – Trade Regulation Rules**

▼ <b>Title 16</b> Commercial Practices	Part / Section
▼ <b>Chapter I</b> Federal Trade Commission	0 – 999
▼ <b>Subchapter D</b> Trade Regulation Rules	408 – 463
▼ <b>Part 436</b> Disclosure Requirements and Prohibitions Concerning Franchising	436.1 – 436.11
▼ <b>Subpart A</b> Definitions	436.1
§ 436.1 Definitions.	
▼ <b>Subpart B</b> Franchisors' Obligations	436.2
§ 436.2 Obligation to furnish documents.	
▼ <b>Subpart C</b> Contents of a Disclosure Document	436.3 – 436.5
§ 436.3 Cover page.	
§ 436.4 Table of contents.	
§ 436.5 Disclosure items.	
▼ <b>Subpart D</b> Instructions	436.6 – 436.7
§ 436.6 Instructions for preparing disclosure documents.	
§ 436.7 Instructions for updating disclosures.	
▼ <b>Subpart E</b> Exemptions	436.8
§ 436.8 Exemptions.	
▼ <b>Subpart F</b> Prohibitions	436.9
§ 436.9 Additional prohibitions.	
▼ <b>Subpart G</b> Other Provisions	436.10 – 436.11
§ 436.10 Other laws and rules.	
§ 436.11 Severability.	
<b>Appendix A to Part 436</b>	
Sample Item 10 Table—Summary of Financing Offered	
<b>Appendix B to Part 436</b>	
Sample Item 20(1) Table—Systemwide Outlet Summary	
<b>Appendix C to Part 436</b>	
Sample Item 20(2) Table—Transfers of Franchised Outlets	
<b>Appendix D to Part 436</b>	
Sample Item 20(3) Table—Status of Franchise Outlets	
<b>Appendix E to Part 436</b>	
Sample Item 20(4) Table—Status of Company-Owned Outlets	
<b>Appendix F to Part 436</b>	
Sample Item 20(5) Table—Projected New Franchised Outlets	

**EXHIBIT 2**

# Potential Fields for Executive Summary

## Franchise Investment Considerations:

- If you become our franchisee, you will have the right to use our prescribed trademarks and system of doing business, which may change from time to time.
- There is no assurance that we will have a permanent relationship or that the terms of our relationship will not change in any successor period.
- As in any business, there is no guarantee of success.

		Item # FDD	Article # FA
Year Founded	#		
Year Began Franchising	#		
Domestic Company Owned Units EOY	#		
Increase/Decrease Over Prior Year	#		
Domestic Franchisee Owned Units EOY	#		
Increase/Decrease Over Prior Year	#		

# Potential Fields for Executive Summary

		Item # FDD	Article # FA
Franchisor Net Worth EOY	\$		
Franchisor Income/Loss Prior Year	\$		
Franchisor Gross Revenue	\$		
Percent from Initial Franchise/Development Fees	%		
Percent from Royalty	%		
Percent derived from Franchisee's mandatory purchases	%		
Number of Lawsuits Disclosed (Consumer lawsuits)	#		
Number initiated by Franchisor	#		
Number of Federal and State Regulatory Proceedings Disclosed	#		

# Potential Fields for Executive Summary

		Item # FDD	Article # FA
Franchisee Advisory Council	y/n		
Name and Contact of President of FAC			
Independent Franchisee Association	y/n		
Name and Contact of President of FA			
Franchisor maintains active relationship with FA	y/n		
Initial Investment Range	\$		
Working Capital Range	\$		
Initial Single-Unit Franchise Fee	\$		
Reduced initial franchise fee for single unit Franchisees	y/n		
Continuing Royalty	%		
Royalties can be changed during the term	y/n		

# Potential Fields for Executive Summary

		Item # FDD	Article # FA
Brand Fund Contribution	%		
Brand Fund audited	y/n		
Do Franchisees have a right to Brand Fund financial reports?	y/n		
Local Advertising Contribution	%/ \$		
Can be increased during the term?	y/n		
Purchases from specified/required suppliers	y/n		
Will Franchisor earn revenue or receive any rebates on Franchisee purchases?	y/n		
Multi-unit franchises available?	y/n		
Are there veteran or minority programs available?	y/n		
Does Franchisor provide any financing?	y/n		

# Potential Fields for Executive Summary

		Item # FDD	Article # FA
Requirements for franchise owner to personally manage the business	y/n		
Hardware and software requirements	y/n		
Technology Fees (aggregate)	\$ AND y/n		
Does Franchisor derive income from the Tech Fee?	y/n		
Fee increase allowed during term?	y/n		
Length of initial franchise term	#		
Are successor/renewal terms included in franchise agreement	y/n		
What is the amount of the successor/renewal fee	\$/%		

# Potential Fields for Executive Summary

		Item # FDD	Article # FA
Number of successor/renewal terms available	#		
Length of successor/renewal terms	#		
Successor/renewal agreement may contain material differences from current agreement.	y/n		
Eligibility requirements to enter into successor/renewal agreement	y/n		
Right to transfer/sell franchise if not renewed	y/n		
Transferee must meet franchisor's then current objective and subjective standards for new franchisees	y/n		
Capital/remodel obligations for transferee	y/n		
Franchisor can terminate the franchise without cause	y/n		
Franchisee can terminate the franchise without cause	y/n		

# Potential Fields for Executive Summary

		Item # FDD	Article # FA
Liquidated damages for termination/abandonment	y/n		
Non-compete requirements during the term	y/n		
Non-compete requirements after the term	y/n		
Designated location for Dispute Resolution	State		
Methods for dispute resolution – Ombudsman, Mediation, Arbitration, Litigation			
Right to sell/transfer franchise	y/n		
Transferee must meet franchisor's then current objective and subjective standards for new franchisees	y/n		
Transfer Fee	\$%		
Franchisor right of first refusal	y/n		

# Potential Fields for Executive Summary

		Item # FDD	Article # FA
Transferee receives current form of agreement for full term	y/n		
Conditions required for transfer (reinvestment, release of claims, etc)	y/n		
Protected territory provided	y/n		
Geographic limitations on development of new locations	y/n		
Franchisor can offer Brand products/services on internet or otherwise in protected territory	y/n		
Does franchisor have an encroachment/impact policy?	Y/n		
Length of initial training	#		
On-line pre-training offered/included	y/n		
Length of headquarters training	#		

# Potential Fields for Executive Summary

		Item # FDD	Article # FA
Length of on-the-job training	#		
Length of pre-opening support/training provided	#		
Train the trainer program included	y/n		
Is the Field service support provided included in fees	y/n		
Does the FDD include information about the financial performance of existing outlets	y/n		
Does the franchisor provide supplemental financial performance representations upon request	y/n		
Is the financial performance broken down geographically	y/n		
Does the information show financial performance for new franchise openings	y/n		
Does the financial performance include unit operating costs	y/n		
			9

## Speaker Biographies

**Sarah Davies** is the General Counsel of the International Franchise Association (IFA). Prior to joining IFA, Sarah served as General Counsel for a boutique fitness franchisor and quick service restaurant franchisor and practiced in the global supply chain and franchise practices at several law firms, most recently DLA Piper.

**Ronald K. Gardner**, a founding partner of the firm of Dady & Gardner, P.A., limits his practice to the representation of Franchisees, Franchisee associations, dealers and distributors, focusing most frequently on his clients' disputes with their Franchisors, manufacturers and suppliers. Dady & Gardner, P.A. has an international reputation for helping their Franchisee, association, dealer and distributor clients to resolve their disputes through negotiation, mediation, and when necessary, litigation and arbitration. Ron is a member of the American, Minnesota, Hennepin County and Rice County Bar Associations, an active member of the ABA Forum on Franchising, and a Past Chair of the Forum (the first "Franchisee lawyer" to be elected Chair). Ron is also a member of the North American Securities Administrator Association Franchise Project Advisory Group, which helps to promulgate franchise regulations and train state franchise regulators in the nuances of franchise law. Ron is an author and a highly sought-after lecturer on topics related to franchise/distribution law. He is listed as a Best Lawyer in America, has been named one of Minnesota's Top 100 Super Lawyers seven times (including 2023), and has been recognized by Chambers USA as "the premier Franchisee lawyer" in America. He was recognized as "Franchise Lawyer of the Year" in Minnesota by Best Lawyers for 2015, 2019, and again in 2023.

**David Oppenheim** is Co-Managing Shareholder of the New Jersey office, concentrates his practice on domestic and international franchising, licensing, and distribution matters. He is recognized by Chambers USA as a leading, national franchise attorney. He advises both emerging and mature companies with respect to planning, structuring, and implementing national and international franchise, distribution, and licensing programs, including negotiating franchise agreements, ancillary agreements, regulatory compliance, including the preparation of franchise disclosure documents, and securing registration of franchise offerings in the United States and abroad.

David is also experienced in mergers and acquisitions and sophisticated financing transactions, including the securitizations of a franchisor's royalty stream. He represents private equity firms and public and private companies in the acquisition of franchise, licensing, and distribution systems. David routinely counsels clients regarding the implementation of compliance programs and system-wide standards. He also advises franchise clients regarding complex franchise relationship issues and disputes.

**Karen Satterlee** is Senior Vice President and Assistant General Counsel – APAC for Hilton Worldwide. In this role, Ms. Satterlee manages the Legal function for Hilton in the Asia Pacific region (China, India, Southeast Asia, Japan/Korea/Micronesia and Australasia). Key responsibilities include: serving as a member of the Senior Executive Committee of Hilton in APAC; leadership, management and supervision of the APAC Legal team located in Singapore, China, Japan and India; management of outside counsel; general oversight and management of all legal matters in APAC including dispute resolution and compliance; management of the regional Legal budget; protection of the company's commercial interests and risk management in the region; providing strategic advice and overseeing legal services to the corporate development function and individual hotel development transactions; and building and implementing Hilton's APAC franchising strategy. Ms. Satterlee is a current member of the International Franchise Association's Board of Directors. She is also a Past Chair of the American Bar Association's Forum on Franchising's Governing Committee. Ms. Satterlee is a former member of the Board of Trustees

for the International Franchise Association's Educational Foundation and the Board of Governors for the Institute of Certified Franchise Executives. Ms. Satterlee is an Adjunct Professor of Law at American University's Washington College of Law and has authored numerous articles on franchise law and is a frequent speaker at legal and industry conferences.