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FRANCHISE  
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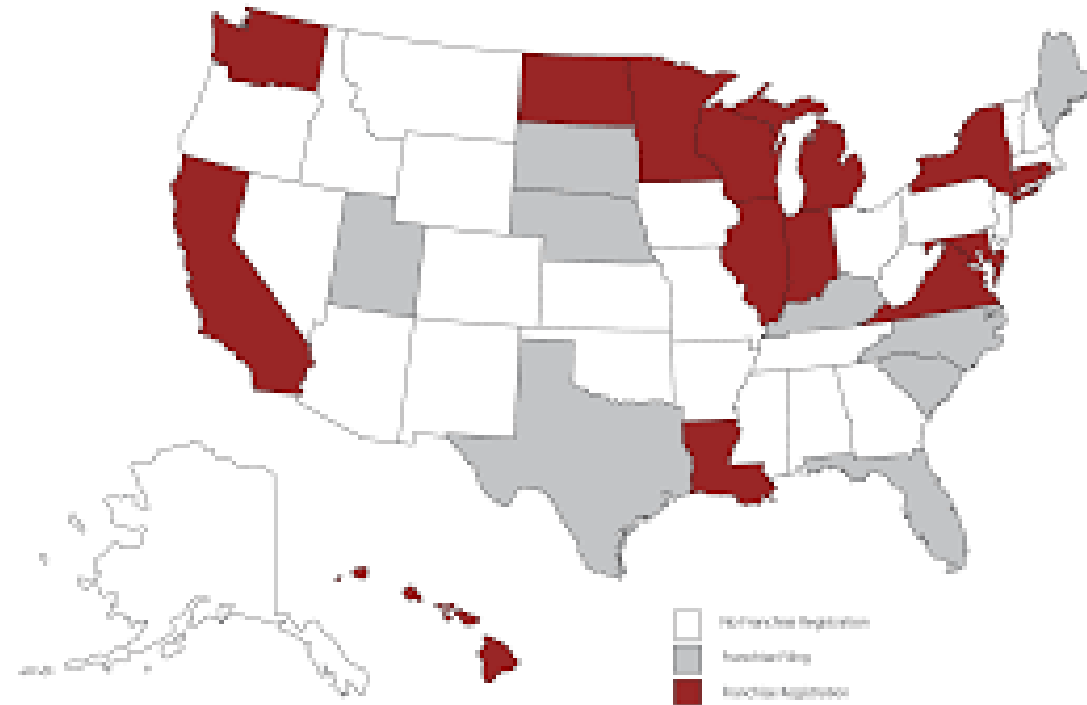
# LEGAL

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# Franchise Disclosure Under the Microscope

## State Registration Trends



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# Speaker Disclaimer

The Views expressed by the speakers today are their own and do not necessarily reflect the official position or policies of any state agency, NASAA or law firm.



# Program Overview

- Disclaimers
- Fee Disclosures
- State Addenda



# Disclaimers in the FDD

- Item 7 – Estimated Initial Investment
- Item 11 – Assistance & Training
- Item 19 – FPRs
- Item 20 – Confidentiality
- NASAA SOP Acknowledgments & Questionnaires



# The Federal Standard: 16 CFR § 436.9(h)

- Bans FDD disclaimers and waivers of reliance
- Reaches the FDD, exhibits, and amendments
- Cannot be evaded indirectly
- **Key tension: explanation vs. disclaimer**



**Note:** 16 CFR § 436.9(a) prohibits statements inconsistent with the FDD in communications outside the FDD

# Item 7 Example



## Non-compliant footnote language illustrations:

- ❖ *“You should not rely on these estimates in deciding whether to invest”*
- ❖ *“Actual costs may be substantially higher”*

## More specific but not needed if range in column 2 is accurate:

- ❖ *“Estimates reflect our experience operating outlets. Actual costs vary by location, size, and market conditions”*
- Explanatory context **may** be permissible; disclaiming reliance is not

# Item 7 Examples – Compliant?



- ❖ “Your costs may vary based on a number of factors including but not limited to the geographic area in which you open, local market conditions, the time it takes to build your sales and your skills at operating a business”
- ❖ “These are only estimates and your costs and, the range of those costs, may vary”
- ❖ “As of the date of this Disclosure Document, inflation rates, contractor costs and building supplies are at all-time highs, and the impact of tariffs (if implemented) are unknown”

**Note:** See NASAA Advisory: *Impact of Shifting Market and Economic Factors on Franchise Disclosures*



# Item 11 Example

## Required prescribed opening (bolded in FDD):

- ❖ *“Except as listed below, [Franchisor] is not required to provide you with any assistance”*
- ✓ Mandatory disclosure, not a waiver
- ✓ Defines scope of support; does not disclaim it
- ✓ Counters assumption of unlimited franchisor assistance

# Item 19 Example



**Compliant – federal admonition 16 CFR § 436.5(s):**

❖ *“Some outlets have earned this amount. Your individual results may differ. There is no assurance that you’ll earn as much”*

**Non-compliant – added disclaimer language:**

❖ *“These figures may not be representative of the typical franchisee, and we make no representation as to their accuracy”*

➤ Generalized caveats that the FPR is not representative or accurate are treated as prohibited disclaimers (See NASAA FPR Commentary)

# Item 20 Example



## Required confidentiality disclosure:

*“In some instances, current and former franchisees sign provisions restricting their ability to speak openly about their experience with [Franchisor]. You may wish to speak with current and former franchisees but be aware that not all such franchisees will be able to communicate with you”*

- ✓ Required when confidentiality clauses signed in last 3 years
- ✓ FTC chose disclosure over an outright ban
- ✓ Protects due diligence; preserves franchisor interest

# NASAA Statement of Policy Regarding the Use of Questionnaires and Acknowledgements

- Adopted Sept. 2022; effective Jan. 1, 2023
- Targets fraud-defense use of acknowledgments
- Requires anti-disclaimer legend in FDD
- Lists 11 specific prohibited statements



# NASAA SOP: Prohibited Statements

## Examples from the list of 11 (non-exhaustive):

- Franchisee has read or understands the FDD
- Franchisee comprehends the risks of the franchise
- Franchisee relied solely on the FDD
- No representations were made outside the FDD
- Success depends solely or primarily on the franchisee



# NASAA SOP Anti-Disclaimer Legend:



*“No statement, questionnaire, or acknowledgment signed or agreed to by a franchisee in connection with the commencement of the franchise relationship shall have the effect of (i) waiving any claims under any applicable state franchise law, including fraud in the inducement, or (ii) disclaiming reliance on any statement made by any franchisor, franchise seller, or other person acting on behalf of the franchisor. This provision supersedes any other term of any document executed in connection with the franchise.”*

➤ **Aligns with the Registration States’ anti-waiver provisions**

# State Implementation

Implementation is based on state anti-waiver provisions:

- California – CA Corp Code sections 31512 and 31512.1
- Washington – formally adopted SOP, Sept. 2023
- Maryland – interpretive opinion applies SOP requirements
- Other states – comment letters demand conformity



➤ **End result is the same**

# Practical Drafting Hierarchy

- Apply the federal floor
- Review each state's anti-waiver provisions
- Audit existing questionnaires against NASAA's SOP
- Review Item 19 language carefully



# The Federal Standard: 16 CFR § 436.5(f)

## Item 6: Other Fees

- Include any formula used to compute the fees
- IF fees **may increase**, disclose the formula that determines the increase or maximum amount of increase.





# Examples – Variable Fee Disclosures

## Fixed schedule:

\$500/month, years 1–5; \$600/month, years 6–10

## Range:

Currently between \$345 and \$595 per month



# Examples – Variable Fee Disclosures

## Percentage cap:

- \$299/month; we may increase by up to 10% once per calendar year
- Company's then current fee, which is currently \$500/per day, and will not exceed \$100,000 per day



## Index-tied:

Adjusted annually in accordance with any annual change in the CPI-U

# Examples – Variable Fee Disclosures

## Formula:

- Fee = Out of pocket cost to provide technology / # U.S. outlets

## Discretionary (**not compliant**):

- Fees may change from time to time as determined by Franchisor
- Franchisor's then current [training] fee



# Best Practices

- Provide a cap or range
- Clarify the basis for increases
- Provide specifics



# State Addenda

- State Addenda Disclosures
- Post-Term Non-Compete Clauses
- How Courts Interpret



# Common Addenda Provisions

- Non-waiver of state law
- Anti-disclaimer protections
- Choice of law
- Forum and arbitration situs
- Termination protections
- Non-compete restrictions



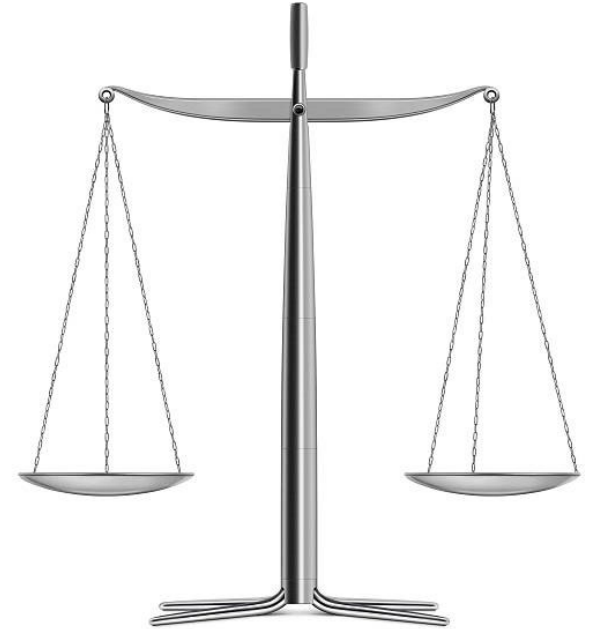
# State Addenda Disclosures

- Required by state law
- Not negotiable



# NASAA Advisory on Post-Term Non-Compete Clauses

- Narrow
- Reasonable
  - ✓ Scope
  - ✓ Duration
  - ✓ Geographic restriction
- Tailored to specific business interests



# Example – sandwich franchise



“For 2 years after the Franchise Agreement is terminated or expires, you and your immediate family members, may not own, maintain, engage in any Competitive Business located or operating: (i) within the Metropolitan Statistical Area, as defined by the United States Census, Bureau, in which your Restaurant is located; (ii) within a 10-mile radius of the Premises; or (iii) within a 10-mile radius of any other outlets.”

# How Courts Interpret

Approaches:

1. Supplements choice of law
2. Carve-out for state-law claims
3. Independent contract rights



**The breadth of the addendum often determines the result**

# Supplements vs. Carve-Out



## Long John Silver's — Supplements:

- MN addendum read narrowly; KY venue proper
- Providing of substantive rights does not control venue

## Chorley v. Dickey's (4th Cir.) — Carve-Out:

- MD law “controls” inconsistent provisions
- Common-law claims to arbitration; MD statutory claims to court
- Questioned FAA preemption presumption

# Servpro: Addendum as Contract Rights

- Sixth Circuit decision in Servpro v. Woloski
- Reframes inquiry: contract interpretation, not choice of law
- CA addendum “enshrined” CFRA rights as contract rights
- Defeats franchisor’s choice-of-law argument



**Drafting takeaway: addendum breadth determines reach**

# Q&A



# The End

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"It's even worse. It's a cease, desist,  
and knock it off already."