

THE FRANCHISE SELLER'S HANDBOOK

2010

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*For Use in the U.S. and Its
Territories Under The FTC
Franchise Rule And State
Franchise Disclosure Laws*

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This handbook is a quick-reference tool for use in beginning to understand how to comply with federal and state laws that regulate the offer and sale of franchises, and is not legal advice. You should review actual current laws, regulations and opinions, and should confer with experienced franchise counsel, before making any decisions about your legal obligations or rights.

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Lewis, Warren Lee, 1945-

The Franchise Seller's Handbook

ISBN [_____]

1. Franchising. 2. Success in business. 2. Entrepreneurship.



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INTRODUCTION: MAKING LEGAL FRANCHISE SALES

A Franchise Seller

If you are an officer, employee, representative or broker involved in the offer or sale of franchises, you are a “franchise seller.” As a franchise seller, you can use this handbook to help you make legal franchise sales.

Your involvement in the offer or sale of franchises may be obvious, such as if you are a salesperson actively pursuing franchisee prospects for a franchisor, are signing agreements with new franchisees, or are accepting payments from new franchisees. Or, your involvement may be less obvious, such as if you are participating as a finder or consultant in discussions with prospects about their business interests, pre-screening prospects through questionnaires, recommending franchise options, or assisting prospects in completing franchise application forms. In either case, you are involved in the offer and sale of franchises, making you a franchise seller.

Your Obligations as a Franchise Seller

As a franchise seller, you must comply with the FTC franchise rule and numerous state laws that regulate the offer and sale of franchises.

The FTC franchise rule requires a franchisor to prepare a Franchise Disclosure Document, known as an FDD; to keep the FDD updated as “material changes” occur, new audited financials are issued and new fiscal years phase in; to follow and have its franchise sellers follow basic franchise sales steps in dealings with prospects; and to modify the basic franchise sales steps in certain special situations.

In addition, the FTC franchise rule permits and prohibits specific activities during the franchise sales process. The FTC franchise rule does not require a franchisor’s FDD to be filed with the FTC, but it does permit the FTC to investigate

and punish franchisors and franchise sellers believed to have violated the rule.

About half of the states have laws that may require a franchisor to register its FDD or file a notice with the state before offering or selling a franchise that has some connection to the state (see Appendix A). The triggering connection may be based on the residency of the prospect, the location of the franchised business, or the occurrence of communications within, into or out of the state. Several state laws require a franchisor and its franchise sellers to follow special disclosure timing rules (see Appendix A). Those laws may change, so you should check with the franchisor's lawyer or compliance manager about when any changes might take effect.

Penalties for Not Meeting Your Obligations

If you do not meet your obligations under the FTC franchise rule and state franchise disclosure laws ("state laws"), you and the franchisor you represent could suffer significant penalties.

The most frequent penalty is a claim or lawsuit by a franchisee which is costly to defend, and which results in a settlement or judgment requiring the franchisor to rescind or void the franchise agreement, refund the franchisee's payments, or reimburse the franchisee's damages, attorney's fees and costs. This penalty can be financially debilitating or devastating.

Another common penalty is the loss of your job or relationship with a franchisor.

The states often seek penalties, including: orders which must be disclosed to prospects for 10 years or longer; monetary payments to franchisees or the states; or restrictions on your future business activities.

In some instances, a penalty may be an FTC investigation that results in an order which you must disclose to future prospects, a freeze of your assets, civil penalties of up to \$10,000 per violation, payments to franchisees, or an injunction.

In rare instances, a penalty may be a state criminal prosecution against you.

Hopefully, your desire to make legal franchise sales and this array of possible penalties will motivate you to make a serious effort to meet your legal obligations during the franchise sales process.

What to Do When You Make a Mistake

All franchise sellers make mistakes at times when trying to comply with the FTC franchise rule and state laws, because so many technical requirements are involved. This means that you will make mistakes.

When you make a mistake, you will have two choices. Keep it to yourself, or tell the franchisor's lawyer or compliance manager about it. If you keep it to yourself, you may think it will go away and never hurt or be discovered by anyone, but you may be missing an opportunity to cure the mistake or minimize its potential damage. You also may be violating a policy of disclosure adopted by the franchisor you represent. On the other hand, if you tell the franchisor's lawyer or compliance manager about the mistake, you and the franchisor you represent will be able to decide, jointly and with full knowledge of all options, on the best way to deal with the mistake.

How to Use this Handbook

This handbook supplements, but does not substitute for, the legal and business advice that you need on an ongoing basis from the franchisor's lawyer, compliance manager and franchisor executives about how to comply with the FTC franchise rule and state laws. Laws, regulations and interpretations change, the facts in each situation are unique, and different franchisors have different policies and legal risk tolerances, so you should not rely on this handbook alone to make a final decision about how to act during the franchise sales process.

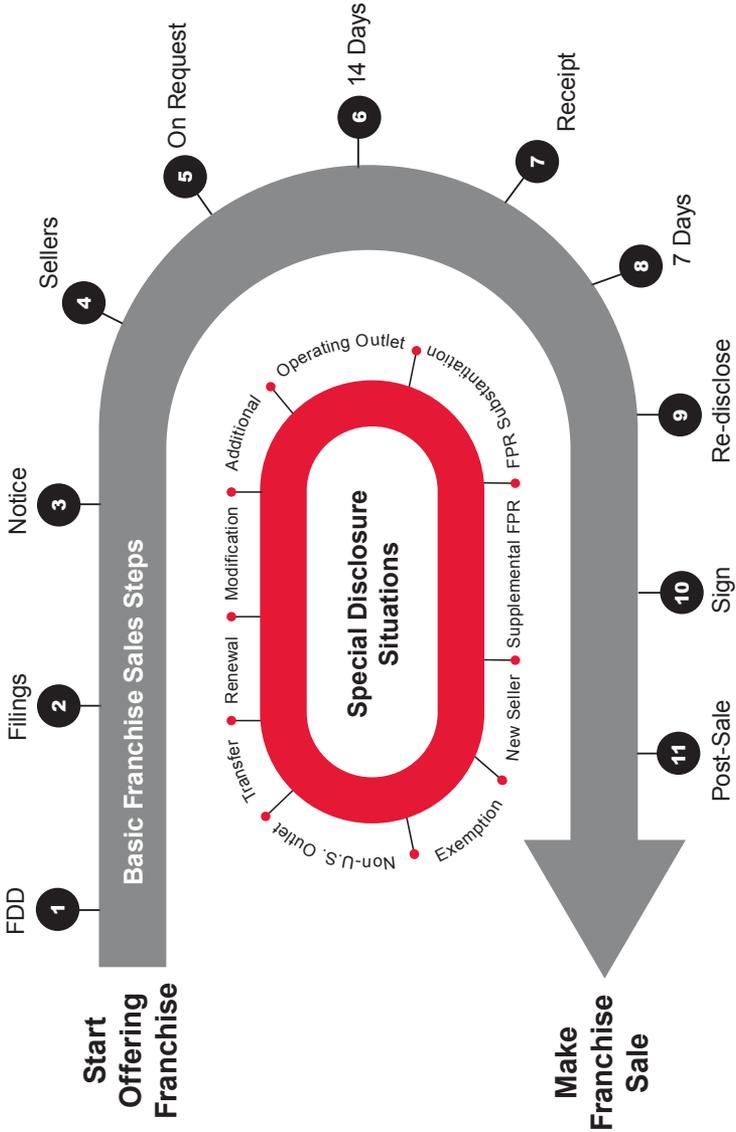
You should use this handbook to inform and remind yourself about the key issues affecting franchise sellers. Chapter 1 describes the 11 basic franchise sales steps that you must know (see Diagram 1). Chapter 2 describes 10 special situations that could modify the basic franchise sales steps (see Diagram 1). Chapter 3

describes activities that are permitted during the franchise sales process. Chapter 4 describes activities that are prohibited during the franchise sales process. Appendix A is a list of states with registration, notice and special disclosure timing requirements that may affect you. Appendix B is a glossary of some common franchise sales terms that you must understand.

Good luck, and enjoy offering and selling franchises with a clear understanding of your legal obligations, and with confidence that you are making legal franchise sales.

Diagram 1. The Franchise Sales Process

THE Franchise Sales PROCESSSM



CHAPTER 1: BASIC FRANCHISE SALES STEPS

If you want to make a legal franchise sale, you must follow certain basic franchise sales steps. Those steps are described below.

The steps apply if you are offering or selling a franchise to a new franchisee for a new outlet, if the outlet will be located in the United States, if you will be offering or selling franchises in one or more states with franchise disclosure laws, and if you are not exempt from following the steps under the FTC franchise rule and state law. In the special situations discussed later in this handbook, the steps may apply, may not apply, or may be modified.

Step 1: Current FDD

You must have a current Franchise Disclosure Document (FDD). It must be in the format specified under the FTC franchise rule and state laws.

The FDD may be paper or electronic. In either case, it must be a “single document.” In other words, for example, the franchise agreement and the franchisor’s financials must be integrated into the FDD, and may not be free-standing. If the FDD is electronic, it may contain scroll bars, search features, internal links and limited external links, but it must not contain multi-media features such as audio, video, animation, pop-up screens or other external links.

The FDD must be current. This generally means that it must have been updated within 120 days after the franchisor’s most recent fiscal year end, and, in addition, must have been updated promptly after the occurrence of any “material change” (anything such as a lawsuit, bankruptcy, fee increase, cost increase, financial reversal, or other change that might be significant to a prospect). So, if the franchisor has a fiscal year ending December 31, the FDD must be updated no later than April 30 (120 days after December 31). If it is not, you must not offer or sell the franchise. Similarly, if the franchisor was sued by a franchisee under a state law or increased its initial franchise fee in August, and you are about to disclose a prospect in September, the

FDD must have been updated to disclose the lawsuit or increased fee. If it was not, you must not offer or sell the franchise. You should check with the franchisor's lawyer or compliance manager before using any FDD that might be outdated.

There may be times, in a franchise registration state, when you can use an FDD that has not been updated within 120 days after the franchisor's most recent fiscal year end – if the FDD is registered with the state and the registration is effective longer than 120 days after the fiscal year end. There also may be instances when you can use an FDD that has not been updated after a “material change” has occurred – such as when only the more lenient updating requirements in the FTC franchise rule apply. In determining whether the FDD is current, you must be particularly careful during any period that the franchisor's FDD must be updated or amended because of a “material change.” If you want to disclose a prospect during that period, in some instances you may be permitted to use the previous FDD, but in other instances, you may not. Even if you are permitted to use the previous FDD, you may be required to re-disclose the prospect with the updated FDD before you sell a franchise. Always check with the franchisor's lawyer or compliance manager before proceeding in this type of situation.

Step 2: State Registration or Notice

In order to offer or sell franchises in certain states with franchise disclosure laws (see Appendix A), the franchisor must have effective registrations or notices in those states.

A state law may cover the offer or sale of a franchise if the prospect resides in the state, if the franchised business will be fully or partially operated in the state, or if any communications about the franchise offer or sale are made in, into or from the state. State laws vary in terms of when they apply, so if any state listed in Appendix A is involved in any manner, you should check with the franchisor's lawyer or compliance manager about whether that state's law applies. If the law applies and the franchisor does not have an effective registration or notice, you may be prohibited from offering or selling the franchise until after the franchisor obtains a registration or files a notice.

If the franchisor is registered with a state, the state and the effective date of the registration should be noted at the bottom of, or immediately after, the state cover page in the FDD. No effective date for a state with a state law likely means that the franchisor will need to obtain a registration from that state before you make an offer or sale covered by the law. An old effective date likely means that the franchisor's FDD or registration will need to be updated before you make an offer or sale covered by the law. If you have any question about a state, check with the franchisor's lawyer or compliance manager.

No effective date, or an effective date that is not within the previous 12-month period, for a notice state such as **Florida, Indiana, Kentucky, Michigan, Nebraska, Texas** or **Utah**, may not be a problem (see Appendix A), since effective dates for those states are not required to be in the FDD, and since some of those states permit notices to remain effective indefinitely unless specific changes occur, such as address changes.

State laws require registered FDDs to be updated annually, or immediately, promptly or within a reasonable time after "material changes" occur. See the discussion about this issue under "Step 1: Current FDD" above.

Step 3: Notice of FDD Formats Available

Before furnishing an FDD to a prospect, you must confirm that the prospect has been given, or must give the prospect, notice of the FDD formats available, and the prerequisites and conditions for obtaining those formats.

The law does not require the notice to be in writing or to be acknowledged. The notice may be given personally, by telephone or in writing by paper or electronically. However, as a matter of policy, a franchisor may require the notice to be in writing, and may require the prospect to sign or initial an acknowledgment of the notice. This type of policy protects the franchisor and you from later claims by prospects that they were not given the notice.

The notice must be given to a prospect before an FDD is furnished to the prospect. If the notice is posted on the franchisor's website or included in the franchisor's marketing materials or franchise application

form, and if the prospect has visited the website, received the marketing materials or submitted an application form, the prospect has been given notice. However, you should not assume this to be the case. You should confirm that the prospect has been given notice, or you should give the prospect notice, before you furnish an FDD to the prospect. You should be particularly careful if you are dealing with a prospect who meets you at a trade show, a renewing franchisee, a current franchisee buying an additional franchise, or a transferee of a current franchisee. These types of prospects are least likely to have been given the notice.

The notice must be given whether the franchisor uses just paper FDDs, just electronic FDDs, or both paper and electronic FDDs. The specific wording of the notice is not prescribed by law.

If a franchisor uses both paper and electronic FDDs, the notice could state:

Notice of Available Disclosure Formats

If you qualify as a franchisee prospect, we will furnish you with our franchise disclosure document in paper form unless you request an electronic copy by sending an email request to [name, title] at [email @franchisor]. We will provide the paper form of our franchise disclosure document to you in person if you visit our offices, or we will mail or courier the document to you at our cost. We will provide the electronic form of our franchise disclosure document to you in PDF format, sent by email to the address you provide to us. You will need to have Adobe Reader software installed on your computer to open and view the PDF document and a printer to print at least one Receipt page.

If a franchisor uses just paper FDDs, the notice could state:

Notice of Available Disclosure Formats

If you qualify as a franchisee prospect, we will furnish you with our franchise disclosure document in paper form. We will provide the document to you in person if you visit our office, or we will mail or courier the document to you at our cost.

Step 4: Notice of “Franchise Sellers” Involved

Before furnishing an FDD to a prospect, you must confirm that both receipts at the end of the FDD identify all “franchise sellers” who have been or will be involved in offering the franchise to the prospect. The receipts must state the franchise sellers’ names, business addresses and business telephone numbers. Or, the receipts may refer to an exhibit containing the franchise sellers’ names and contact information.

The meaning of the term “franchise sellers” is narrow for this purpose. The FTC wants the receipts to identify the persons who have been or will be dealing directly with the prospect, including key officers or employees and any broker. The FTC does not want the receipts to identify all persons who arguably might be franchise sellers in a broad sense, or to cross-reference lists of brokers or other persons who might sometimes represent the franchisor. A few key persons who are involved in all or most franchise offers and sales for the franchisor may be pre-identified on all receipts. Other persons, such as brokers who deal occasionally with the franchisor’s prospects, must be identified in typing or handwriting on the receipts, on a prospect-by-prospect basis. Any person who will receive a sales commission or quota credit if a franchise is sold to the prospect must be identified.

See the discussion in the section below on “Situation 8: New ‘Franchise Seller’ After Disclosure” concerning what must be done if a franchise seller not identified on the receipts becomes involved with the prospect after disclosure has occurred.

Step 5: Disclosure Whenever Requested By Prospect

The franchisor must furnish its FDD to a prospect whenever the prospect reasonably requests it. If you merely represent the franchisor and do not handle disclosure directly, you must communicate the request to the franchisor. The franchisor then must fulfill the request.

A request from a person who has not yet qualified and been accepted as a prospect does not trigger this step. Only a request from a bona fide prospect triggers it.

The purpose of the step is to permit the prospect to obtain and review the FDD before incurring significant costs to investigate the franchise or travel to the franchisor's office. Therefore, the franchisor may not refuse to furnish the FDD until, for example, the prospect attends discovery day.

The FTC franchise rule does not require a request to be in writing, and does not say how quickly an FDD must be furnished after it is requested. Presumably, most prospects will make requests by telephone or in emails. You and the franchisor must establish and maintain a system for recording and responding promptly to these requests. The FTC franchise rule assumes a prompt response, but permits some flexibility based on extenuating circumstances such as a poorly timed request (for example, a request made late on Friday afternoon) or a request made when the FDD is being updated. If a request is made when the FDD is being updated because of a "material change" (see "Step 9: Re-Disclosure If 'Material Change' Occurs" below), you or the franchisor may respond that the FDD is being updated and will be furnished after it is updated or registered.

The FTC franchise rule permits you to furnish the FDD directly to the prospect or to a representative of the prospect, such as a partner, owner, officer, employee, agent, lawyer or accountant. Some states may not permit you to accomplish disclosure by merely furnishing the FDD to a representative. Check with the franchisor's lawyer or compliance manager.

You are not required to furnish an FDD in the particular format requested by a prospect. However, if the prospect refuses to accept delivery of an FDD because of its format, you may not make a franchise offer or sale to that prospect.

Neither you nor the franchisor may charge any fee in connection with a prospect's right to receive an FDD whenever he or she reasonably requests it.

Step 6: Minimum Disclosure Timing

You must disclose a prospect with the franchisor's FDD a minimum amount of time before the prospect signs any binding agreement with, or pays any amount to, the franchisor or any affiliate.

If you are using a paper FDD or an FDD on a CD, disclosure occurs on the day you hand-deliver or otherwise actually deliver the FDD to the prospect, or 3 days after you mail the FDD to the prospect by first class mail. If you are disclosing electronically, disclosure occurs on the day you email the FDD to the prospect, or give the prospect directions for accessing the FDD on the Internet. The date on the signed and dated receipt received from the prospect for the FDD (see Step 7 below) should correspond to the date disclosure occurs.

In most states, the minimum disclosure time is 14 calendar days before the prospect signs or pays. When counting calendar days, you may not count the day the FDD is delivered or the day the prospect signs or pays.

Some state laws require different minimum disclosure times (see Appendix A). If the **Iowa, Maine, Maryland, Nebraska, New York, Oklahoma** or **Rhode Island** law applies, you may be required to disclose the prospect at your first “personal meeting” with the prospect. A “personal meeting” is a face-to-face meeting in a semi-private setting such as a restaurant or a lounge area at a tradeshow, or in a private setting such as a hotel conference room or your office. If the **Connecticut, Maryland, Michigan, New York, Oklahoma, Rhode Island, Texas, Utah** or **Washington** law applies, or if you are exempt as a large franchisor in **California**, you may be required to disclose the prospect at least 10 business days before the prospect signs or pays. When counting business days, you may not count the day the FDD is delivered, the day the prospect signs or pays, Saturdays, Sundays, or most federal or state holidays.

Some of the state laws requiring different minimum disclosure times may be changed, so you should check with the franchisor’s lawyer or compliance manager about when any changes might take effect. Until all of the state laws are changed, however, your franchisor may require you to disclose all prospects at their first personal meetings and at least 10 business days before they sign or pay, just to be safe in case any of the laws apply.

Step 7: Receipts

The franchisor's FDD should contain two last pages that are nearly identical receipts.

After you furnish the FDD to a prospect, you must obtain from the prospect the receipt indicated to be for the franchisor, after it has been dated and signed by the prospect. The date must be the day of disclosure, not an earlier or later date. You may help the prospect to identify or remember the day of disclosure, but the prospect, not you, must date and sign the receipt. It is best to obtain a manually signed and dated original of the receipt, but it is acceptable to obtain a faxed or emailed copy of a signed and dated receipt, or a receipt that is electronically signed and dated. The receipt may be returned by a means different from the means used to furnish the FDD to the prospect.

Under the FTC franchise rule, a prospect's signature may be handwritten, or may be a security code, password, electronic signature or other device authenticating the prospect's identity. The franchisor, however, may have a policy of only accepting handwritten signatures. Check with the franchisor's lawyer or compliance manager.

If you are using an electronic FDD, the receipts must be contained within the FDD. The prospect must be required to open the entire FDD in order to locate and print the receipts.

You should encourage the prospect to date, sign and keep the other receipt indicated to be for the prospect.

Step 8: Providing Final Agreements to Prospect

The franchisor or you will be preparing and providing to the prospect the final agreements to be executed by the parties.

If the final agreements differ from those in the FDD only to the extent of "fill-in-the-blank provisions" (see definition in Appendix B) or changes made in response to negotiations initiated by the prospect, then you are not required to observe a waiting period before having the prospect sign the agreements, assuming that the minimum disclosure period for the FDD has expired.

If the final agreements differ from those in the FDD in other ways, you must observe a 7-calendar-day waiting period before having the prospect sign the agreements. The types of changes that trigger a 7-calendar-day waiting period include, for example, specifying the geographic scope of a protected territory that was not specified in the FDD, specifying the initial franchise fee if it can vary, specifying sales quotas or interest rates if they can vary, specifying the number of outlets to be opened under an area development agreement, or changing any terms in the agreements unilaterally. When providing final agreements with these types of changes, you must highlight the changes to the prospect in some manner, such as a cover letter or black-lined document. When counting calendar days, you may not count the “action days”---the day the final agreements are delivered or the day the prospect signs them. If the prospect negotiates additional changes during the waiting period, you are not required to re-start the waiting period.

As a matter of policy, the franchisor may require you to obtain a dated and signed receipt for the final agreements from each prospect and to observe 7-business-day waiting period with every prospect. Check with the franchisor’s lawyer or compliance manager.

You may provide the final agreements on the same day that you furnish the FDD, or you may provide the final agreements at a later time. If you provide the final agreements when or shortly after you furnish the FDD, the 7-calendar-day waiting period for the final agreements runs concurrently with the 14-calendar-day minimum disclosure period or any 10-business-day minimum disclosure period.

Step 9: Re-Disclosure If “Material Change” Occurs

If a “material change” occurs at any time after you furnish a prospect with the franchisor’s FDD, the franchisor must update the FDD, and you must re-disclose the prospect with the updated FDD and re-observe all waiting periods.

A “material change” may be voluntary or involuntary.

Voluntary “material changes” include, for example, changes to any fee, the size of territories, territorial rights, any substantive term in any agreement in the FDD, the products or services offered by fran-

chisees, the initial investment required or the franchisor's name, and may include changes to the franchisor's leadership team. A lawsuit filed by the franchisor against a franchisee generally is not a material change that requires immediate updating and re-disclosure, even though the franchisor must disclose the lawsuit when it does its annual FDD update.

Involuntary "material changes" generally are negative, and include, for example, a significant legal proceeding brought against the franchisor or anyone on its leadership team, a significant deterioration in the franchisor's financial condition, a bankruptcy of the franchisor or anyone on its leadership team, a significant loss of franchisees in a state or nationally, the loss of an important trademark registration, or a similar adverse development.

If you are concerned about whether a "material change" has occurred, check with the franchisor's lawyer or compliance manager before continuing to offer the franchise or having a prospect sign final agreements or make any payment to the franchisor or any affiliate.

You may be told that the FTC franchise rule does not require re-disclosure. To some extent this statement is true. However, most state laws, as well as general state common law fraud principles, require re-disclosure.

Step 10: Execution of Agreements

The franchise sales process does not end until final agreements are executed by the parties. When you receive back the final agreements signed by the prospect, they are not executed. The franchisor must countersign the agreements for them to be executed. Only when the franchisor countersigns the agreements does the franchise sale occur and the prospect become a franchisee.

If a "material change" occurs, or if a state registration expires, before the franchisor countersigns the agreements, obligations to re-disclose the prospect and re-observe all waiting periods may be triggered. So, if the franchisor wants the prospect as a franchisee, you should arrange for the franchisor to countersign the agreements as soon as possible.

Step 11: Post-Sale Obligations

The franchisor must retain a copy of each materially different version of its FDD for 3 years after the close of the fiscal year when it was last used. Some states require longer retention periods.

If the prospect signs a franchise agreement, during the entire life of the franchise and for several years beyond, the franchisor should retain copies of all communications from and to the prospect during the franchise sales process, and copies of all signed FDD receipts and all executed final agreements. By law, signed FDD receipts must be retained at least 3 years, or even longer for sales in some states.

Even if the prospect does not sign a franchise agreement, the franchisor should retain copies of all signed FDD receipts, and of all communications from and to the prospect during the franchise sales process, for at least 3 years, or even longer for offers in some states.

CHAPTER 2: SPECIAL DISCLOSURE SITUATIONS

The special situations described below may excuse you from following, or may modify how you follow, the basic franchise sales steps described earlier in this handbook. As to each prospect, you must determine whether a special situation applies and how that affects your disclosure obligations.

If you think a special situation is involved, check with the franchisor's lawyer or compliance manager before making a decision not to follow the basic franchise sales steps.

Situation 1: Transfer of Franchise

FTC Franchise Rule. Under the FTC franchise rule, if an existing franchisee is transferring a franchise to a new owner, you must follow the basic franchise sales steps for the new owner if the terms of the new owner's agreements will be materially different from the terms of the existing franchisee's agreements, or if the franchisor has had or will have significant involvement with the new owner during the transfer process.

If the new owner will be signing the franchisor's current agreements, as opposed to the agreements previously signed by the existing franchisee, it is likely that the current agreements contain materially different terms and that you must follow the basic franchise sales steps. Or, if you or the franchisor located the new owner for the existing franchisee, or have or will become involved in "selling" the new owner on the benefits of becoming a franchisee, it is likely that you are required to follow the basic franchise sales steps.

If the new owner will be assuming the agreements previously signed by the existing franchisee, and if you and the franchisor have been or will be involved with the new owner during the transfer process only to determine whether to approve the transfer and to negotiate the terms of the franchisor's consent to the transfer, it is likely that you are not required to follow the basic franchise sales steps. This will be very advantageous if the transfer is occurring in a regulatory state (see

Appendix A) and the franchisor is not currently registered or on file with the state, because you may proceed without following the basic franchise sales steps. However, even if you are not required to follow the basic franchise sales steps, the franchisor may have a policy of requiring you to provide the new owner with an updated FDD “for informational purposes” before the transfer occurs. Check with the franchisor’s lawyer or compliance manager before making a decision not to follow the basic franchise sales steps.

State Laws. The laws of the regulatory states (see Appendix A) generally are consistent with the FTC franchise rule, but they contain some anomalies. For example, the **New York** law requires the existing franchisee (seller) to furnish to the prospective franchisee (buyer) a copy of the franchisor’s FDD currently registered with the New York Department of Law, at least 7 calendar days before the earlier of payment by the buyer to the seller, or the execution of any binding purchase agreement. Most of the state laws excuse an existing franchisee from registering or filing a notice before dealing with a prospective new owner, as long as the transfer involves an entire franchise. Special rules may apply if the transfer involves just part of a franchise, such as part of a territory. Some state laws are silent on how transfers should be handled, but generally are enforced consistent with the approach under the FTC franchise rule. If you think a state law might apply, check with the franchisor’s lawyer or compliance manager about any special requirements.

Situation 2: Renewal or Extension of Franchise

FTC Franchise Rule. Under the FTC franchise rule, if the franchise of an existing franchisee is being renewed or extended, you must follow the basic franchise sales steps if the existing franchisee signs agreements with materially different terms, or if there is an interruption in the operation of the franchisee’s business.

If the franchisee will be signing the franchisor’s current agreements, as opposed to the original agreements signed by the franchisee, it is likely that the current agreements contain materially different terms and that you must follow the basic franchise sales steps.

If the franchisee will be granted a renewal or an extension period

without any other changes in the terms of original agreements, it is likely that you are not required to follow the basic franchise sales steps. This is true even if the franchisee will pay a fee for the renewal or extension period.

State Laws. The laws of the regulatory states (see Appendix A) generally are consistent with the FTC franchise rule, but some of the laws are silent on renewal and extension issues. If you think a state law might apply, check with the franchisor's lawyer or compliance manager about any special requirements.

Situation 3: Modification of Franchise

FTC Franchise Rule. The FTC franchise rule does not require you to follow the basic franchise sales steps if the franchisor and an existing franchisee agree to modify their existing agreements, even if the modifications are material. It does not matter whether the modifications are sought by the franchisor or the franchisee.

State Laws. Most state laws are silent on the issue of modification, but some of the laws require the basic franchise sales steps or special disclosure procedures to be followed. For example, the **California** law has very detailed special disclosure rules that must be followed if the franchisor seeks a material modification to a franchisee's existing agreement. Similarly, the **North Dakota** law permits a material modification of an existing franchise agreement as an exemption to registration requirements if the franchisor discloses to each franchisee information about the specific sections of the franchise agreement that are proposed to be modified. If you think a state law might apply, check with the franchisor's lawyer or compliance manager.

Situation 4: Sale of Additional Franchise to Existing Franchisee

Unless the FDD originally used to disclose an existing franchisee is still effective, you must follow the basic franchise sales steps in offering and selling an additional franchise to an existing franchisee. This is true even if the agreements for the additional franchise are materially the same as the agreements for the franchisee's existing franchise or franchises.

Situation 5: Sale of Operating Outlet

You must follow the basic franchise sales steps if the franchisor is selling an operating outlet to a prospect.

If the operating outlet was previously franchisee-owned, you must provide a prospective purchaser with the following additional information, for the franchisor's last 5 fiscal years:

- the name, city, state, and current business telephone number (if known) or last known home telephone number of each previous owner
- the time period when each previous owner controlled the outlet
- the reason for each previous ownership change (for example, termination, non-renewal, voluntary transfer, ceased operations, reacquired by the franchisor, etc.)
- the time period(s) when the franchisor controlled the outlet.

The additional information may be attached to the franchisor's FDD as an addendum when the FDD is furnished to the prospect, or may be provided later to the prospect in a supplement to the previously furnished FDD. The addendum or supplement must be given to the prospect at least 14 calendar days before the prospect signs any binding agreement with, or pays any amount to, the franchisor or any affiliate.

At your option, you may provide a prospective purchaser of the operating outlet with information about the actual operating results of that outlet. The information is not required to be attached to the franchisor's FDD or to be put into any particular format. For example, it may include unaudited financial statements for the outlet.

You may not provide the prospective purchaser with information about the operating results of other operating outlets. Similarly, you may not provide information about the operating results of the outlet to prospective purchasers of other operating outlets or of franchises for new outlets.

Situation 6: Written Substantiation of FPR

The franchisor must have written substantiation in its files for any financial performance representation – also called an FPR – made in Item 19 of its FDD. On reasonable request by a prospect, you or the franchisor must make available to the prospect the written substantiation for any FPR. You and the franchisor must establish and maintain a system for documenting receipt of these requests, and responding promptly to these requests.

Who May Ask For Substantiation. A person who has not yet qualified or been accepted as a prospect may not make a request that triggers this obligation. Only a request from a bona fide prospect who has received an FDD containing an FPR triggers this obligation.

Form of Request. The FTC franchise rule does not require a request to be in writing, so you may not require a prospect to submit the request in writing. Presumably, most prospects will make requests by telephone or in emails.

Timing for Response. The FTC franchise rule does not say how quickly the written substantiation must be made available after it is requested. The FTC franchise rule assumes prompt responses, but permits some flexibility if, for example, a request is made at an inconvenient time or the franchisor needs a reasonable period of time to review the written substantiation before making it available.

Form of Response. The written substantiation is not required to be in any particular format. The FTC franchise rule states that the written substantiation must be “made available” to a prospect, not that it must be “furnished,” “provided” or “delivered” to a prospect. The use of “made available” indicates that it may be sufficient to give the prospect a reasonable opportunity to review the written substantiation at the franchisor’s office or at another mutually convenient location, and that it may not be necessary to give the prospect copies of the written substantiation, which may contain personal or highly confidential information.

Situation 7: Supplemental FPR

If the franchisor makes a financial performance representation – also called an FPR – in Item 19 of its FDD, you or the franchisor may furnish to a prospect a supplemental FPR about a particular location or variation. For example, if the FPR in the FDD gives average sales and cost information for all outlets in a system and the prospect is considering an urban location, the supplemental FPR could focus on the sales and costs of just urban outlets in the system. The supplemental FPR may be a document separate from the FDD, but must:

- be in writing
- explain the departure from the FPR in the FDD
- be prepared in the same manner as a standard FPR
- be furnished to the prospect.

Situation 8: New “Franchise Seller” After Disclosure

As indicated in the section above on “Step 4: Notice of ‘Franchise Sellers’ Involved,” the receipts at the end of an FDD must identify all franchise sellers who have been or will be involved in offering a franchise to the prospect.

Sometimes, a new franchise seller not identified in the FDD, such as a new employee of the franchisor or a new broker, will become involved in offering a franchise to the prospect after disclosure has occurred. When this happens, you or the franchisor must revise the dated and signed receipt previously obtained from the prospect so that the receipt identifies the new franchise seller, and must furnish a copy of the revised receipt to the prospect. Revising the receipt may involve merely making a copy of the receipt with the new franchise seller’s business card shown on the receipt or with information about the new franchise seller handwritten on the receipt. You and the franchisor are not required to have the prospect re-date or re-sign the receipt.

Situation 9: Exemption

FTC Franchise Rule. The FTC franchise rule may exempt you from following the basic franchise sales steps. For example, you may be exempt if the franchise involves:

- a required payment of less than \$500 within the first 6 months
- a fractional franchise within an established business
- a leased department within an established retail business
- a transaction covered by the Petroleum Marketing Practices Act
- an initial investment of \$1,000,000 or more, excluding the cost of unimproved land
- a prospect with at least 5 years of business experience and a net worth of at least \$5,000,000
- a prospect related to the franchisor
- a purely oral franchise.

Each exemption has specific requirements and conditions, so before relying on any exemption in the FTC franchise rule, check with the franchisor's lawyer or compliance manager.

State Laws. Even if the FTC franchise rule exempts you from following the basic franchise sales steps, if a state law applies and does not exempt you from following the steps, you must follow the basic franchise sales steps because of the state law. Even if the state law contains a similar exemption, the requirements of the state exemption may be narrower than the requirements of the FTC franchise rule exemption. For example, the **New York** law's fractional franchise exemption is much narrower than the fractional franchise exemption in the FTC franchise rule. Before you rely on an exemption in the FTC franchise rule, check with the franchisor's lawyer or compliance manager about whether any state law may negate the exemption.

Situation 10: Non-U.S. Outlet

FTC Franchise Rule. Under the FTC franchise rule, you are not required to follow the basic franchise sales steps if the prospect will be granted a franchise for an outlet not located in the United States or any U.S. territory. It does not matter whether the prospect resides in or outside of the United States or its territories. The rule simply does not apply if the outlet, including all protected market area associated with the outlet, will be outside of the United States and its territories.

Please note that if you are dealing with a prospect residing outside of the United States for an outlet to be located in the United States or any U.S. territory, or if you are dealing with an outlet located outside of the United States – such as in Canada or Mexico – but grant a protected territory that extends into the United States, you must follow the basic franchise sales steps.

NOTE: For any prospect or outlet in another country, you may be required to comply with that country's franchise laws, such as the Canadian provincial franchise laws and the Mexican franchise law.

State Laws. Some state laws may require you to follow the basic franchise sales steps even if the prospect will be granted a franchise for a non-U.S. outlet. For example, the **Maryland** and **New York** laws may require you to follow the basic franchise sales steps if the prospect is a resident of the state, even if the outlet will be located outside of the United States. If you think a state law might apply, check with the franchisor's lawyer or compliance manager about your disclosure obligations.

CHAPTER 3: PERMITTED FRANCHISE SALES ACTIVITIES

Permitted 1: Advertising

You and the franchisor may use “advertising” to promote the sale of franchises, subject to the limitations discussed below.

“Advertising” includes website pages, Internet ads, magazine ads, newspaper ads, brochures, handouts, CDs and DVDs oriented to prospects. Less obviously perhaps, “advertising” includes blank pro formas given to prospects, form letters or emails used to communicate with prospects, and copies of published articles and other materials given to prospects. For purposes of this handbook, “advertising” does not include consumer-oriented materials, such as sample ads, menus or point-of-sale displays, shown or given to prospects.

Advertising must be truthful and not misleading. For example, advertising may not reference studies that purport to show that franchisees are more successful than independent business people, if those studies, such as the discredited U.S. Department of Commerce or Gallup studies, have been found to be unreliable.

Advertising may not expressly or impliedly assure or guarantee success, profitability, earnings, or a safe investment that is free from risk of loss or default. Therefore, variations on the words “success,” “profit,” “proven,” “lucrative” and “recession-proof,” or any other term that states or implies earnings, must be used carefully and sparingly in advertising.

Advertising must be consistent with information in the franchisor’s FDD. As to fees and initial investment costs, advertising must be supported by information in the FDD. For example, any initial fee or initial investment information in advertising must match, and may not go beyond, what is in the FDD. Advertising may not include financial performance representations, also called FPRs, unless the same FPRs are included in Item 19 of the franchisor’s FDD.

Advertising may provide some supplemental information that is not required or permitted to be included in the FDD. For example, a franchisor executive is required to include 5 years of employment history in Item 2 of an FDD and may not include more unless the executive has held the same position with the franchisor for longer than 5 years. Advertising may include much more information about an executive's experience and background.

A franchisor is prohibited from including a blank pro forma in its FDD, but it may provide a blank pro forma to a prospect to show typical categories of sales and costs. The franchisor may not help the prospect to fill in the blank pro forma. If used in this manner, the blank pro forma is advertising that provides permitted supplemental information to the prospect.

Advertising on the franchisor's website must include a disclaimer such as the following:

NOTE: This website is not a franchise offering. A franchise offering can be made by us only in a state if we are first registered, filed, excluded, exempted or otherwise qualified to offer franchises in that state, and only if we provide you with an appropriate franchise disclosure document. Follow-up or individualized responses to you that involve either effecting or attempting to effect the sale of a franchise will be made only if we are first in compliance with state registration or notice filing requirements, or are covered by an applicable state exclusion or exemption.

*The following states regulate the offer and sale of franchises: **California, Florida, Hawaii, Illinois, Indiana, Kentucky, Maryland, Michigan, Minnesota, Nebraska, New York, North Dakota, Rhode Island, South Dakota, Texas, Utah, Virginia, Washington and Wisconsin.** If you reside, plan to operate or will communicate about the franchise in one of these states, you may have certain rights under applicable franchise laws or regulations.*

This disclaimer should be on or linked to the first website page oriented to franchisee prospects, but is not required to be on or linked to each website page oriented to franchisee prospects.

You may run ads in national publications such as *Franchising World*, *Entrepreneur*, *Franchise Times* or *Franchise Update*, and may post pages oriented to franchisee prospects on the franchisor's website, without pre-submitting the ads or pages to any states.

You must pre-submit, before use, other types of advertising, such as local newspaper ads, brochures, handouts, CDs, DVDs, blank pro formas, form letters and emails, and copies of articles distributed to franchisee prospects, to the following states: **California, Maryland, Minnesota, New York, North Dakota, Rhode Island and Washington.**

New York requires you to add the following disclaimer to advertising:

NOTE: This advertisement is not an offering. An offering can only be made by a prospectus filed first with the Department of Law of the State of New York. Such filing does not constitute approval by the Department of Law.

California and **Washington** sometimes require you to pre-submit written consents permitting the use of third-party endorsements, such as franchisee testimonials.

Permitted 2: Communications Before and During Waiting Periods

Before you furnish the franchisor's FDD to a prospect, you may communicate in writing and orally to a prospect on a regular basis, as long you and the franchisor are properly registered or on file with any involved regulatory state (see Appendix A), and as long as your statements are consistent with the standards for advertising discussed above (truthfulness, consistency with the FDD, etc.).

After you have furnished the franchisor's FDD or final agreements to a prospect, you may continue to communicate in writing and orally to a prospect on a regular basis during any 14-calendar-day, 7-calendar-day or 10-business-day period that may be running. You are not required to observe a "cooling-off" period during which you must cease all communications with the prospect.

Permitted 3: Confidentiality Agreement

FTC Franchise Rule. Under the FTC franchise rule, you or the franchisor may require a prospect to sign a confidentiality agreement before you furnish the franchisor's FDD to the prospect, or before you grant the prospect access to the franchisor's proprietary information or operations manual. This type of agreement does not trigger any disclosure obligations under the FTC franchise rule, as long as it does not contain any other type of agreement that triggers disclosure. The franchisor is not required to include the confidentiality agreement as an exhibit in its FDD.

State Laws. For a prospect covered by a state law, the franchisor may be required to include any required confidentiality agreement as an exhibit in its FDD; and you and the franchisor may be required to furnish the FDD to the prospect and observe a 14-calendar-day or 10-business-day waiting period, before requiring the prospect to sign the confidentiality agreement. State prohibitions and requirements vary in this area, so check with the franchisor's lawyer or compliance manager.

Permitted 4: "Cost Information Alone" Outside FDD

FTC Franchise Rule. Under the FTC franchise rule, you or the franchisor may give "cost information alone" to a prospect outside of the franchisor's FDD, even if that information is not in the FDD or supported by information in the FDD. This is because a financial performance representation – also called an FPR – is defined to include a representation that indicates, expressly or by implication, a specific level or range of actual or potential sales, income, gross profits or net profits, but not a specific level or range of actual or potential costs.

This is a tricky and dangerous area, so you or the franchisor may very well choose not to give "cost information alone" to prospects outside of the franchisor's FDD.

First, it is difficult to distinguish between "cost information alone" and other types of cost-related information. For example, it is permissible to say that "on average, our franchisees spend about \$10,000 a month on ground beef" or "typically, ground beef costs are about 10%

of total monthly costs,” if that is true. However, it is not permissible to say “on average, hamburger costs are about 3% of total sales,” since that representation involves a comparison with sales, and therefore, is not “cost information alone.” These types of subtle differences are hard to manage and monitor.

Second, even “cost information alone” needs to be put in a proper context in order not to be misleading. For example, if you say “on average, our franchisees spend about \$10,000 a month on ground beef,” questions such as the following arise: what were the lowest and highest amounts spent per month, what percentage of franchisees reported this information, for what period was the information reported, was the information reliable, have costs changed, and do costs vary in different regions of the country? These types of questions can be answered properly when cost information is included in Item 19 of the franchisor’s FDD, but are much more difficult to answer properly when cost information is given outside of the FDD.

State Laws. For a prospect covered by a state law, you and the franchisor may be prohibited from discussing any cost information with the prospect unless the cost information in the franchisor’s FDD. State prohibitions and requirements vary on this issue, so check with the franchisor’s lawyer or compliance manager.

Permitted 5: Discovery Day

The franchisor may invite a prospect to attend a “discovery day” at the franchisor’s office as part of the franchise sales process. This gives the prospect and the franchisor’s management team an opportunity to meet each other face-to-face, and to determine whether the franchise is a good fit for the prospect.

Employees of the franchisor who understand the do’s and don’ts of the basic franchise sales steps, special situations, and permitted and prohibited activities discussed in this handbook, must design and handle discovery day. Statements made to the prospect, orally or by a PowerPoint® presentation, and paper materials or software programs given to the prospect, must not contain financial performance representations or other representations inconsistent with or unsupported by the franchisor’s FDD.

Permitting a prospect to view or participate in any other type of program, such as a regular franchisee training session, or to roam and talk with employees in the franchisor's office, should be avoided. It invites the danger of the prospect being given an improper financial performance representation or other improper information.

Areas of the franchisor's office that are accessible to the prospect – including the reception area, halls, conference rooms and employees' work areas – must not contain plaques, certificates, flip charts, newsletters or other documents displaying financial performance representations, such as the monthly or annual sales of the top-grossing franchisees in the system or other representations that the prospect could later claim were improper or misleading.

Permitted 6: Negotiation

The franchisor may negotiate with a prospect, subject to the limitations discussed below.

The information and exhibits in the franchisor's FDD must reflect the franchisor's actual initial offer to a prospect. If, based on changing conditions or other factors, the franchisor has decided to change its initial offer, for example, by increasing its initial fee from \$25,000 to \$30,000, it must amend its FDD before furnishing the FDD to a prospect. It may not furnish a FDD with a \$25,000 initial fee and tell the prospect that the initial fee is actually \$30,000, in effect "negotiating up" from what is offered in the FDD. Similarly, if the franchisor has decided to decrease its initial and royalty fees, it must amend its FDD to reflect the changes and its actual initial offer to a prospect, even though the changes favor the prospect.

A prospect may initiate negotiations with the franchisor before or after receiving the franchisor's FDD. In response, the franchisor may refuse to negotiate (except in *Virginia*, as discussed below), or may negotiate or indicate a willingness to negotiate. Negotiation may be about any matter, and may continue until the prospect signs final agreements.

Negotiated changes made as a result of negotiations initiated by the prospect do not trigger the 7-calendar-day waiting period for final agreements. If the prospect negotiates additional changes during

any 7-calendar-day waiting period, the changes do not trigger an additional waiting period.

Give and take is permitted during negotiations. You or the franchisor may require the prospect to agree to terms more favorable to the franchisor, or may require the prospect to voluntarily waive terms and conditions, in exchange for agreeing to terms more favorable to the prospect. Under the FTC franchise rule, the prospect must merely be aware of all of the changes.

California is the only state that requires filings, approval and disclosures to later prospects if you or the franchisor negotiate with a prospect. Check with the franchisor's lawyer or compliance manager if you need or want to negotiate with a prospect covered by the **California** law.

New York requires negotiated changes overall to favor the prospect. This is not a requirement under the FTC franchise rule or an explicit requirement under other state laws. As a practical matter, however, most negotiations result in negotiated changes overall that favor the prospect.

Virginia requires the franchisor to negotiate with the prospect, but does not require the franchisor to agree to any concession requested by the prospect.

Permitted 7: Supplemental Material Information

The FTC franchise rule prohibits a franchisor from including any information in an FDD that is not required by the rule or state laws or regulations. The rule contemplates, however, that there will be times when a franchisor will want to provide a prospect with supplemental material information, or even will be required by other federal or state laws to provide a prospect with supplemental material information.

Supplemental information could include, for example, background information on the franchisor's executives or on litigation not required to be disclosed in an FDD.

CHAPTER 4: PROHIBITED FRANCHISE SALES ACTIVITIES

Prohibited 1: Disclaimers or Waivers of Representations in FDD

You must not disclaim or require a prospect to waive reliance on any representation made in the franchisor's FDD, including any exhibit in the FDD. The only exception to this prohibition is when a prospect voluntarily waives specific contract terms or conditions in the course of negotiation (see "Permitted 6: Negotiation" above).

The franchisor must make sure that its franchise agreement and other agreements do not contain provisions requiring a new franchisee to acknowledge reliance only on representations in the agreements. This type of provision is prohibited, since it requires a prospect to waive reliance on other representations in the franchisor's FDD.

Prohibited 2: FPRs Outside FDD

A "financial performance representation," also called an "FPR," is any representation, whether oral, visual or written, to a prospect that states, expressly or by implication, a specific level or range of actual or potential sales, income, gross profits or net profits (see definition in Appendix B).

If the franchisor states in Item 19 of its FDD states that it and its representatives do not make FPRs to prospects, you must avoid making any oral, visual or written FPR to a prospect outside of the FDD.

If the franchisor includes FPRs in Item 19 of its FDD, you may discuss any FPR in Item 19 with a prospect, but you must avoid making any oral, visual or written FPR to a prospect that is not in Item 19. For example, if Item 19 gives the average annual sales of outlets open in the previous year, you are prohibited from representing orally that average sales in the current year have exceeded average sales in the previous year, since that oral representation is not supported in Item 19.

Here are some examples of FPRs outside of an FDD that must be avoided:

- A chart, table or mathematical calculation that shows possible results based on a combination of variables.
- A software program containing a spreadsheet with assumed cost percentages.
- A copy of a published article which states that some franchisees have earned a specified amount.
- A pro forma showing assumed low, medium and high sales and costs based on actual average cost percentages.
- “You will earn enough to be own a new Porsche within a year.”
- “You will break even within 6 to 9 months.”
- “Your sales will increase 20% to 30% if you convert to be a franchised outlet.”
- “The sales and cost projections in the pro forma prepared by your accountant look reasonable to me.”
- “You are likely to realize a 100% return on investment within the first year of operation.”

Here are some examples of statements related to sales, profits and costs that likely are not FPRs, subject, of course, to the full context of what is said to a prospect:

- “This franchise offers exceptional profit potential.”
- “Your sales will depend on your location and how much effort you put into the business.”
- “If you want to know about typical sales, profits and costs, you should talk with our franchisees.”
- “This is an opportunity of a lifetime.”

Prohibited 3: Information Contradictory to Information in FDD

You and the franchisor must avoid making any claim or representation to a prospect, orally, visually or in writing, that contradicts any information in the franchisor's FDD. For example, if Item 7 in the FDD states that the initial investment ranges from \$100,000 to \$180,000, you are prohibited from stating orally to the prospect that the initial investment often is less than \$100,000. Or, if Item 5 of the FDD states that the initial franchise fee is non-refundable, you are prohibited from stating orally to a prospect that the fee is refundable in some situations.

Prohibited 4: Use of "Shills"

You and the franchisor must avoid referring a prospect to a "shill." A "shill" is any person misrepresented by you or the franchisor to be the purchaser of a franchise from the franchisor or the operator of a franchise of the type offered by the franchisor, or to be an independent and reliable source about the franchise or the experience of any current or former franchisee.

The prohibition on the use of shills applies to individual shills who are paid or otherwise compensated to provide false favorable testimonials or fictitious references to prospects, and to institutional shills that are paid to purport to act like Better Business Bureaus providing consumers with "independent" reports on their members.

APPENDIX A: REGULATORY STATES AND NON-REGULATORY JURISDICTIONS

Regulatory states if the franchisor has a registered federal trademark:

State	Type of Filing	Special Disclosure Timing
California	registration	10 business days, but only if large franchisor exemption applies
Florida	annual notice	n/a
Hawaii	registration	n/a
Illinois	registration	n/a
Iowa	n/a	first personal meeting
Indiana	annual notice	n/a
Kentucky	1-time notice	n/a
Maryland	registration	first personal meeting; 10 business days
Michigan	annual notice	10 business days
Minnesota	registration	n/a
Nebraska	1-time notice	n/a
New York	registration	first personal meeting; 10 business days
North Dakota	registration	n/a
Oklahoma	n/a	first personal meeting; 10 business days
Oregon	n/a	n/a
Rhode Island	registration	first personal meeting; 10 business days
South Dakota	annual notice	n/a
Texas	1-time notice	n/a
Utah	annual notice	n/a
Virginia	registration	n/a
Washington	registration	10 business days
Wisconsin	annual notice (before sale)	n/a

Additional regulatory states only if the franchisor does not have a registered federal trademark; otherwise, non-regulatory states:

State	Type of Filing	Special Disclosure Timing
Connecticut	registration	10 business days
Georgia	state registered trademark, or special disclosures and consent	n/a
Louisiana	state registered trademark, bond or consent	n/a
Maine	registration	first personal meeting
North Carolina	registration	n/a
South Carolina	state registered trademark or registration	n/a

Non-regulatory jurisdictions (States):

Alabama	Massachusetts	New Mexico
Alaska	Mississippi	Ohio
Arizona	Missouri	Pennsylvania
Arkansas	Montana	Tennessee
Colorado	Nevada	Vermont
Delaware	New Hampshire	West Virginia
Idaho	New Jersey	Wyoming
Kansas		

Non-regulatory jurisdictions (Other):

American Samoa	Northern Mariana Islands (including Saipan)
District of Columbia	
Federated States of Micronesia	Palau
Guam	Puerto Rico
Marshall Islands	Virgin Islands

APPENDIX B: GLOSSARY

Broker. A broker is a person who is under contract with the franchisor relating to the sale of franchises, receives compensation from the franchisor related to the sale of franchises, and arranges franchise sales by assisting prospective franchisees in the sales process. Arranging franchise sales includes, for example, discussions with prospective franchisees about their specific business interests, pre-screening prospects through interest questionnaires, recommending specific franchise options, and assisting prospects in completing a franchisor's application form. Therefore, the term broker covers more than persons who negotiate contract terms or sign franchise agreements and accept payments on behalf of a franchisor, including persons who may call themselves middlemen or finders. An existing franchisee who merely refers a potential franchisee to franchisor is not a broker, because the existing franchisee is not under contract with the franchisor to sell franchises. A broker is not obligated to furnish a franchisor's FDD to a prospect; that is the franchisor's obligation.

Confidentiality agreement. A confidentiality agreement is an agreement that a prospective franchisee may be required to sign before being granted access to the franchisor's operations manual and other proprietary information. Such an agreement may be a necessary step in the franchise sales process. Under the FTC franchise rule, it is not the type of agreement that triggers disclosure obligations, so long as it contains no other type of agreement that would trigger disclosure, such as a lease agreement.

Deceptive. A representation, omission or practice is deceptive if it is likely to mislead a prospect acting reasonably under the circumstances, and if it is material (see definition of "material" below").

Fill-in-the-blank provision. For purposes of a franchise or related agreement, a fill-in-the-blank provision is interpreted narrowly. It applies to an item such as the name or address of the franchisee, or the date of the agreement. It does not apply to an item that has not been disclosed in the FDD, such as the geographic description of a protected territory, an interest rate, or a fee. Filling in the name of a county

when the FDD discloses that territories are granted by county, is a fill-in-the-blank provision; filling in “3 miles” when the FDD discloses that territories range from 1 to 10 miles, is not a fill-in-the-blank provision.

Financial performance representation, or FPR. A financial performance representation, or FPR, is any representation, including any oral, written or visual representation, to a prospective franchisee, including a representation in the general media, that states, expressly or by implication, a specific level or range of actual or potential sales, income, gross profits or net profits. The term includes a chart, table or mathematical calculation that shows possible results based on a combination of variables. The term includes information about expenses as a percentage of revenues. The term does not include “cost information alone.” When a franchisor directs speeches or news releases to prospective franchisees or uses copies of speeches or releases in marketing materials aimed at prospective franchisees, those speeches or releases are financial performance representations.

Franchise. A franchise is any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that: (1) the franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark; (2) the franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation; and (3) as a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate. The FTC franchise rule covers the offer or sale of a franchise only if it is to be located in the United States or its territories, and only if the transaction is not exempted under the FTC franchise rule.

Franchise disclosure document, or FDD. These terms replace the terms “Uniform Franchise Offering Circular” and “UFOC” used previously.

Franchise seller. A franchise seller is an entity or individual who offers for sale, sells or arranges for the sale of a franchise. The term cov-

ers the franchisor and the franchisor's employees, representatives, agents, subfranchisors, and third-party brokers who are involved in franchise sales activities. The term does not cover an existing franchisee who sells only his or her own outlet, and who is otherwise not engaged in franchise sales on behalf of the franchisor. Also, the term does not cover an existing franchisee who merely receives compensation for referring leads to a franchisor but it does cover an existing franchisee who engages in repeated franchise sales as the franchisor's agent, broker or subfranchisor.

Franchisee. A franchisee is an entity or individual who is granted a franchise. The term includes a subfranchisor if the franchisor is seeking to sell subfranchises.

Franchisor. A franchisor is the entity that grants a franchise and participates in the franchise relationship. The term includes a subfranchisor.

FTC franchise rule. The Federal Trade Commission, known as the FTC, has had a franchise rule since 1979. The rule was amended in 2007. The amended rule, and its statement of basis and purpose, can be found at 72 Federal Register 15444-15563 (March 30, 2007).

Furnishing. Furnishing an FDD or other document to a prospective franchisee occurs: (1) on the date it is hand-delivered, faxed, emailed or otherwise delivered; (2) on the date directions for accessing it on the Internet are provided; or (3) 3 calendar days after it is mailed by first-class United States mail.

Material. A representation or omission is material if it is likely to affect the conduct or decisions of a prospective franchisee with respect to the franchise being offered. Materiality is determined under a "reasonable prospective franchisee standard," and must be determined on a "case-by-case basis."

Prospective franchisee, or prospect. A prospective franchisee, or prospect, is an entity or individual (including an agent, representative, or employee) who approaches or is approached by a franchise seller to discuss the possible establishment of a franchise relationship. A person who purchases a franchise directly from an existing franchisee, without significant contact with the franchisor, is a transferee, and is not a prospective franchisee as to the franchisor.

Renewal. In franchising, “renewal” is a “term of art” meaning that on expiration of the initial term of a franchise, the franchisee may have the right to enter into a new franchise agreement, where materially different terms and conditions may apply. In Item 17 of the franchisor’s FDD, the franchisor must state what the term “renewal” means in its franchise system, including, if applicable, a statement that franchisees may be asked to sign contracts with materially different terms and conditions than those in their original contracts.

Sale of a franchise. The sale of a franchise occurs when agreement is reached whereby a person obtains a franchise from a franchise seller for value by purchase, license or otherwise. Extending or renewing an existing franchise agreement where there has been no interruption in the franchisee’s operation of the business is not the sale of a franchise, unless the new agreement contains terms and conditions that differ materially from the original agreement. Also, the transfer of a franchise by an existing franchisee where the franchisor has had no significant involvement with the prospective transferee is not the sale of a franchise as to the franchisor. A franchisor’s approval or disapproval of a transfer alone is not deemed to be significant involvement.

Shill. A shill is a person misrepresented to a prospect to have purchased a franchise from a franchisor or operated a franchise of the type being offered by a franchisor, or misrepresented to a prospect as being able to provide an independent and reliable report about a franchise or the experience of any current or former franchisees.

Signature. Signature has a “very broad” meaning under the FTC franchise rule, and includes any means by which a person can authenticate his or her identity. The term includes a person’s handwritten signature, as well as a person’s use of security codes, passwords, electronic signatures, and similar devices to authenticate his or her identity.

States, expressly or by implication. The phrase “states, expressly or by implication” is used in the definition of financial performance representation, and reflects the FTC’s intent to cover express performance claims, and 2 types of implied performance claims: (1) when a franchisor gives a prospect a few pieces of financial information from which the prospect can fill in the blanks and draw his or her own-

conclusion about a specific level of potential earnings; or (2) when a franchisor implies that a prospect can earn a specific level of income, such as using a proxy for earnings (for example, “You will do so well that you can buy that Porsche.”).

Trademark. A trademark identifies a brand. Typically, a trademark is a word, a word combination, a logo, or a slogan. A federal trademark is registered with the U.S. Patent & Trademark Office, and state trademark is registered with one or more state agencies. If a trademark is not registered, it is a so-called common law trademark.

Transfer. Transfer means an acquisition of a controlling interest in a franchise, during its term, by a person other than the franchisor or an affiliate of the franchisor.

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Warren Lee Lewis is Co-Chair of the Franchising & Licensing Group at Akerman. International Who's Who of Franchise Lawyers has recognized Warren as one of the top 100 franchise lawyers in the United States and top 200 franchise lawyers worldwide. Franchise Times Magazine has designated him as a "Legal Eagle," and Super Lawyers Magazine has recognized him as a "Super Lawyer" in franchising in both Virginia and Washington, DC. Warren is a member of the Advisory Committee to the Franchise & Business Opportunity Project Group of the North American Securities Administrators Association (NASAA), the International Franchise Association (IFA), and the American Bar Association (ABA) Forum on Franchising.

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ABOUT AKERMAN

Akerman is a full-service law firm with about 500 lawyers in offices in California, Colorado, the District of Columbia, Florida, New York, Texas, Virginia and Wisconsin. The Franchising & Licensing Group at Akerman provides legal services primarily to franchisors and subfranchisors involved in franchising, as well as companies that license and distribute goods and services by other methods.

The professionals in the Franchising & Licensing Group are experienced in all aspects of domestic and international franchising, including federal, state and international disclosure and registration requirements, agreement drafting and review, intellectual property (trademarks, copyrights, patents, trade secrets, etc.), litigation, antitrust compliance, and international transactions involving both “inbound” and “outbound” expansion.

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- You want free updates to the handbook by email.
- You have a comment or suggestion about the handbook.
- You have a question about anything stated in the handbook.

Customize or Rebranding

- You want to customize the handbook to fit your company's franchise sales policies and procedures.
- You want to rebrand the handbook for use just within your company.

Training or Assistance

- You want to provide training to your executives, staff and franchise sellers on compliance with federal and state laws during the franchise sales process.
- You want to franchise your business.
- You want to improve your FDD or franchise compliance practices.

Use

Please feel free to use the handbook for informational purposes, whether you are an officer or employee of a franchisor, a franchise seller, or an advisor to a franchisor or franchise seller. Also, please feel free to establish a link to the handbook on your website or blog, or to email the handbook to whomever you believe would benefit from reading it.

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The handbook has been prepared by lawyers at Akerman for informational purposes only and does not constitute legal advice. The information is not provided in the course of an attorney-client relationship and is not intended to substitute for legal advice from an experienced franchise lawyer taking into account the facts in your particular situation. Furthermore, Akerman requests that you do not send confidential information or requests for legal advice via email. We will delete communications of this nature.

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