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Lawyers rule

What we need to know about the new regulations

By Staff

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There isn't a single franchisor out there who isn't spending time this year thinking about the federal government's new Franchise Rule. Yet that's nothing compared to the amount of time transactional lawyers who specialize in franchising are spending with the Rule. Some of them break out into a sweat with the mere mention of "FTC Franchise Rule."

So what better question to ask transactional attorneys than "what are the first things franchisors should consider when following the FTC's Franchise Rule. Here are their answers.



David Beyer

"Franchisors should take full advantage of the liberalized rules on financial performance representations, formerly known as earnings claims. Previously franchisors faced daunting restrictions on sharing cost and expense data of operating units with prospects. Essentially sharing this information required adherence to the rigorous standards for making earnings claims, including that the figures had to be disclosed in writing in item 19 of the UFOC.

"The new rule no longer includes cost and expense data as a financial performance representation. So franchisors can and should share reliable and accurate expense information with prospects and can do so any way they choose.

"This is very important because disputes don't just arise due to failed expectations on the sales or income side, but also frequently on the expense side. The more info a franchisor can impart, and the new flexibility in doing so, will benefit both franchisors and new franchisees and hopefully reduce future disputes."

—David Beyer, DLA Piper



Mark Kirsch

"First, franchisors should recognize that the changes to the FTC Rule are evolutionary, not revolutionary. Second, the new FTC Franchise Rule provides some opportunities that franchisors can take advantage of with respect to sales strategies and processes, including:

"Electronic Disclosure: The FTC Rule has embraced electronic disclosure. This can save time and money, and provide franchisees with documents in a format that many will find easier to use.

"Delivery Requirements: The elimination of the "first personal meeting" rule, and allowing that FDDs can be provided to a franchisee's representative, will clarify when and how an FDD must be provided, and may streamline the sales process.

"Exemptions: The FTC has adopted several exemptions that will streamline sales to large and experienced franchisees, and has clarified that franchise sales for locations outside of the U.S. are not subject to the FTC Rule.

"Financial Performance Representations' The rules for "FPRs," which used to be called 'earnings claims,' have eased up a bit, in that certain 'cost' information is no longer considered a Financial Performance Representation.

"Third, franchisors and their advisors should use this new era of review and evaluation to urge states to bring their laws into greater uniformity and harmony with the FTC Rule."

—Mark Kirsch, Plave Koch

"While the amended FTC Rule includes a number of changes, the good news is, with some prior planning and training, compliance should not be too time consuming or costly for

franchisors. Notwithstanding that, compliance with the changes in Items 3 and 20 are likely to require the dedication of the most time and resources.

"Franchisors should provide training sessions to their employees to explain the rule changes and how those changes impact the day-to-day responsibilities of the personnel. The training sessions should be available to, among others, any personnel who will be involved in the sales process, will have contact with prospective franchisees, or will be involved with updating the FDD.

"Franchisors should consider revising any relevant internal information gathering procedures to reflect the additional disclosures required by amended FTC Rule. Franchisors should ensure that the personnel collecting the information are familiar with the new required disclosures and identify a resource to answer questions regarding the changes.

"The amended FTC Rule permits franchisors to share cost information with prospective franchisees even if that information is not in the FDD. Franchisors should keep in mind that the information cannot be presented as a percentage of sales or in a manner that would give the franchisee sufficient information to back into gross sales information.

"An important change to rules relating to "financial performance representations" is that franchisors are permitted to "slice and dice" the financial data in Item 19 and provide subcategories of financial information. For example, the franchisor can include financial information relating to a new prototype, certain day parts, or specific geographic region; provided that the information is explained and substantiated.

"The first personal meeting, 10 business day and five business day rules have been replaced. With regard to the new hold times, franchisors should keep the following in mind: (a) since the states have not adopted these new hold times, where a state requires a shorter hold times, franchisors must comply with those state rules; (b) the new hold times cannot be used until the franchisor has converted to the new FDD format; and (c) the franchisor's personnel should be carefully trained on these new holds and franchisors should provide a written summary of the hold times to personnel and be prepared to answer questions.

"Until each registration state addresses whether it will adopt the changes to the FTC Rule, there will be a rub between the amended FTC Rule and the requirements for the registration states. Accordingly, franchisors will face some inconsistency between the FTC Rule and the state requirements resulting in uncertainty about what required disclosures must be included in the FDD. While we anticipate that most of the states will adopt the changes, during the upcoming renewal season, state examiners may take a bit longer to review the FDDs and franchisors may receive comments/questions regarding the new disclosures. We suggest that franchisors file a bit early and advise the franchise sales staff to anticipate some delays in the process.

—*Leslie Curran, Plave Koch*

"The new requirements most likely to trap and shock an unwary franchisor, particularly large franchise systems operating multiple concepts, are the new parent and affiliate disclosures. It has always been necessary for a parent or affiliate who guarantees a franchisor's performance to include its own audited financials, but now, a franchisor must also include audited financials for any entity that controls the franchisor (directly or indirectly through one or more subsidiaries) who commits to perform post-sale obligations for the franchisor."

—*Kenneth Costello, Bryan Cave*

"Practitioners should remember that not all of the previous FTC Franchise Rule provisions have disappeared. For example, a couple of the previous exemptions still apply, such as the exemptions for co-operatives and for true partnerships. A new Statement of Basis and Purpose has been published along with the revised FTC Franchise Rule, however we should all remember to consult the original Interpretative Guides when seeking the original purpose of the adoption of the federal franchise law.

"The tension between the federal franchise disclosure law and the state franchise disclosure and registration laws has lessened, but until the states that have franchise laws take further steps, the tension is still there. NASAA published its Franchise Interim Statement of Policy on June 22, 2007, in anticipation of the optional effective date of the revised FTC Franchise Rule. None of the franchise registration states have taken any action to actually amend their statutes to require that franchisors use the revised FTC Franchise Rule format. Expect more of the registration states to announce policies of acceptance of the revised FTC Franchise Rule format based on the NASAA Franchise Interim Statement of Policy, at least until revisions to existing statutes are adopted.



Leslie Curran



Kenneth Costello



Gayle Cannon

"Franchisors should immediately consider revising their franchise agreements to comply with the revised FTC Franchise Rule regarding integration clauses. The revised FTC Franchise Rule did not make integration clauses, which are found in most franchise agreement, void or ineffective. Instead, integration clauses may not disclaim representations made in the disclosure document, although other disclaimers standard in most franchise agreements are still acceptable, such as unauthorized representations made by sellers. Franchisors who do not make this change should expect a comment to revise the integration clause in a deficiency letter, thus delaying their application effective date.

"The changes in the federal franchise law were a long time coming, and most of us welcome those changes. The key word for franchisors, their legal advisors and federal and state administrators is 'Patience.' Over time, the questions that have arisen and will arise in the preparation of the disclosure documents under the revised format will be answered. We can expect Staff Advisory Opinions and guides from the FTC. We can expect further explanations and releases from the administrators in the registration states. We can expect the states to amend their statutes and rules eventually. In the

interim, we must hope that examiners will also have patience with franchisors."

—Gayle Cannon, Haynes Boone



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