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eDisclosure: Best Practices

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By Lee Plave

These are commonly-asked questions. While the landscape will be formally changed when the Federal Trade Commission adopts the new version of its Franchise Rule, many franchisors have already embraced eDisclosure as a means to efficiently and easily provide disclosure to prospective franchisees, to the benefit of all parties concerned. Franchisors that adopt best practices in connection with eDisclosure will want to make sure that all of the important regulatory concerns are addressed.

Considerations

Neither the current FTC Rule nor any of the state standards (except in California and Indiana) contemplate anything other than a “written” UFOC and thus they do address the UFOC format, whether paper-and-ink, electronic, or otherwise. However, by reviewing past FTC staff advisory opinions and through discussions with state and federal regulators, it is possible to discern a consistent pattern of regulatory concerns that franchisors must consider when contemplating how to provide eDisclosure.

Two states have already adopted regulations and policies that explicitly permit eDisclosure, California and Indiana. In addition, the FTC’s ongoing rulemaking has always included provisions allowing eDisclosure. In the staff’s August 2004 report concerning the pending amendments, staff reviewed and revised its initial approach to the amendments, to take into account the impact of the Federal E-SIGN Act passed by Congress and signed into law by President Clinton on June 30, 2000. Some commentators have suggested that the act automatically authorizes franchisors to engage in eDisclosure; whether they are correct or not, prudent business practices suggest that franchisors who adopt eDisclosure also follow best practices to be sure that they address regulatory considerations, since those regulatory considerations closely track the compliance considerations that a franchisor must always address when providing disclosure.

Overall Regulatory Concerns

In reviewing the various letters, staff advisory opinions, comments, and informal remarks by regulators, certain considerations have been legitimately raised about eDisclosure. For example, they have asked that an electronic UFOC be a single, unified document, without external hyperlinks or other extraneous information. This is hardly surprising, and parallels the real-world standard that applies in the paper-and-ink setting.

Early FTC staff advisory opinions addressed a consideration that is instructive, even if it is no longer a technical problem – compatibility. FTC Informal Staff Advisory Opinion 97-2 was concerned with whether or not the version of the UFOC provided to a prospective franchisee on a “diskette” would be compatible with that prospect’s computer (remember *Commodore* and *Atari* computers?). While this particular technical consideration is no longer a factor, the conceptual issue remains: can the prospective franchisee receive and read the UFOC if you provide it to them electronically? Today, with the widespread use and availability of convenient and low-cost (or free) software to store and retrieve documents, it hardly matters whether the recipient of eDisclosure uses an IBM-compatible computer or an Apple-based computer, whether they view the Web using Microsoft Internet Explorer, the Mozilla Firefox browser, or the new AOL Explorer browser, to name just a few variations. Additionally, regulators were concerned that the eDisclosure UFOC be provided in a software format that can not only be read on the franchisee’s computer, but also in a form that can be downloaded or viewed over long period of time, and in a form that can neither be altered nor changed by the recipient. Regulators also wanted to be sure that if the UFOC were sent by diskette or CD, it should bear a label to indicate that it contains a UFOC, with the franchisor’s name, address, and the date of issuance.

Some considerations have fallen by the wayside, such as the initial idea in an early draft of the amended FTC Rule that a printed table of contents needed to be provided simultaneously with the eUFOC.

In adopting regulatory and policy positions that permit eDisclosure, examiners in California and Indiana closely followed the 2003

North American Securities Administrator's Association policy statement that outlined the process. NASAA's policy statement requires that the franchisor can prove that it delivered the eUFOC as a predicate to being able to give electronic disclosure in the first place. Whether or not this means that there is an after-the-fact test, and whether or not this limitation is permissible (given the effect of the E-SIGN Act, which Congress intended to preempt almost all federal and state laws that interfered with parties' abilities to transact and provide documents such as a UFOC in electronic form), franchisors need to take this point into account for simple and practical reasons – namely, franchisors ultimately may have to prove delivery of a UFOC, whether paper or electronic, for basic regulatory purposes and in private matters, e.g., disputes with a franchisee. The NASAA policy statement also requires the franchisor to keep eDisclosure records and make them available to the state agency.

These regulatory considerations lead to a few overall conclusions about how to prepare an eUFOC: the eUFOC must be provided in a single, unified document, preferably in a "PDF" (portable document format) file that cannot be altered by the recipient; without external hyperlinks (internal links such as "click here to go to Item 11" or "click here to go to the franchise agreement at Exhibit A" are acceptable); without other extraneous content (e.g., no copies of advertising materials as an appendix to Item 11); and in a fashion that allows a reasonable prospective franchisee to receive, open, store and print the document on his or her own home computer.

Possibilities

There are three main possibilities available today for providing a UFOC through eDisclosure. In the future, additional possibilities may also present themselves as new technologies and platforms become available, but at present, the possibilities include:

1. This "less is more" approach is very simple—the franchisor sends a copy of the eUFOC to a prospective franchisee as an attachment to an e-mail. Some attractive features of this approach are simplicity, very low cost, flexibility in that it allows the franchisor to revise the UFOC and make the new copy available to prospective franchisees without incurring a material cost to do so, the possibility of a transmission confirmation, standardized cover notes to be used in the cover e-mail to which the eUFOC is attached, and the chance to be very responsive in getting the eUFOC out to one or more persons who may become a prospective franchisee. The downsides to this approach are the simplicity with which the eUFOC can be forwarded on by the recipient (not a problem for all franchisors, but a consideration for many) and the possibility that an eUFOC file may be larger than many systems can handle (while this is not universally the case, it usually depends on how the PDF version of the eUFOC is generated).
2. **Sending the eUFOC on a CD.** Many franchisors already send their UFOC to prospective franchisees by means of a compact disc (CD). This approach has been used by many franchisors for several years, with great success, and with substantial cost of savings. For some prospective franchisees, though, getting a CD containing a UFOC may be easier than trying to download a copy of getting a copy by e-mail. The downside to this approach is that while it saves costs compared to sending paper copies, sending a CD is nowhere near as inexpensive as e-mailing the eUFOC or permitting simple downloads. Additionally, if there is a change to the eUFOC, this approach requires generating and printing up a whole new set of CDs.
3. **Enabling a Download of the UFOC.** Some franchisors make their UFOC available to qualified prospects from their own Web site or from a commercial Web site. This approach also affords substantial flexibility and allows the franchisor to obtain a "receipt" each time a UFOC is downloaded. In addition, the franchisor can control who may receive an eUFOC by giving each prospect a single-use download code. The downside is that there is cost to setting up the Web site (if on the franchisor's own Web site) or engaging a commercial service.

In any of these settings, providing the eUFOC and obtaining a transmission confirmation for delivery of the eUFOC to the prospective franchisee should be sufficient to satisfy most regulatory requirements. The best and most sure-fire way to obtain proof that the UFOC was actually received is the simplest: ask the prospect to open the document, print the last page (which is the Item 23 UFOC receipt), sign and date the receipt, and return it to you. Doing so will go one step further than a delivery confirmation—it will substantiate that the franchisor met every regulatory concern about delivery—that the eUFOC was delivered, that it was compatible with the prospect's computer, and that the eUFOC could be downloaded, read, and printed by the prospect.

Summary - Best Practice Techniques

While various methods can be used to provide eDisclosure, they should all have the following features:

1. Provide the eUFOC in "PDF" format.
2. Send the eUFOC to the prospect—whether by e-mail, via Web site, or with a CD, with a special cover letter or note, identifying the document as an eUFOC and generally describing its contents. (A copy of the table of contents from the eUFOC may prove useful here.)
3. Keep a paper printout of the actual signed transmittal letter, outbound message, e-mail, etc. in the prospective franchisee file.
4. Ask the recipient to open the document and print the last page (which is, of course, the Item 23 UFOC receipt).
5. Ask the recipient to complete, sign and date the Item 23 receipt, and ask the recipient to fax or mail the signed form back to the franchisor. The franchisor should keep this signed form in its prospective franchisee file. If the prospective franchisee does not ultimately sign a franchise agreement, the receipt should still be kept in a compliance file.
6. Keep electronic receipts as well, including e-mail receipts generated by your own software, confirmations provided by commercial services, etc., that verify transmittal of the document to the prospect.
7. Do not conduct a transaction with prospective franchisee who received eDisclosure unless that franchisee has delivered a signed and dated paper copy of the electronic receipt.

There will come a time when electronic receipts will be possible and useful, if not encouraged. Perhaps the regulations will accommodate a simple link from inside the UFOC to a Web page on which the only input possible will be information needed for a prospect to electronically confirm receipt of the eUFOC, without links to any other Web site (not even the franchisor's home page). This would afford electronic receipting for the convenience and benefit of franchisors as well as prospective franchisees, and in a manner consistent with regulatory concerns as well as the legislative direction provided by Congress under the E-SIGN Act. Until then, obtaining a signed and dated paper receipt seems like the best old-school method to effectively and efficiently accomplish eDisclosure.

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