

FRANCHISE COMPLIANCE TRAINING

CBL

Clapp Business Law, LLC

Agenda

- Disclosure requirements
- State registration laws
- Salespersons and brokers
- Franchise advertising materials
- Negotiated deals
- Franchise relationship laws
- Consequences of non-compliance

- What are my legal obligations when selling a franchise?
 - The FTC Rule
 - State Registrations
 - Franchise Disclosure Document

Registration States

California

Hawaii

Illinois

Indiana

Maryland

Michigan

Minnesota

New York

North Dakota

Oregon

Rhode Island

South Dakota

Virginia

Washington

Wisconsin

Business Opportunity States

- Florida (annual)
- Kentucky (one time)
- Nebraska (one time)
- Texas (one time)
- Utah (annual)

2017 STATE FILING FEES

STATE	INITIAL FEE	RENEWAL FEE	AMENDMENT FEE
California	\$675	\$450 online (Effective date assigned)	Post-Effective Amendment: \$50 Pre-Effective Amendment: \$0 Material Modification: \$50
Hawaii	\$125	\$125 (Effective 7 days after filing)	\$125 from Jan. 1, 2014 and thereafter. (for amendments, renewals & initial filings, same price for all)
Illinois	\$500	\$100 (Renewal effective upon filing)	\$25 for an immaterial amendment; \$100 for a material amendment.
Indiana (Notice)	\$500	\$250 (Renewal effective upon filing)	\$0 Amendments and advertising materials are not required to be filed
Maryland	\$500	\$250 (Effective date assigned)	\$100
Michigan (Notice)	\$250	\$250 (Renewal effective upon filing)	\$0
Minnesota	\$400	\$300 (Effective date assigned)	\$100

2016 FILING FEES CONT.

STATE	INITIAL FEE	RENEWAL FEE	AMENDMENT FEE
New York	\$750	\$150 (Effective date assigned)	\$150
North Dakota	\$250	\$100 (Effective date assigned)	\$50
South Dakota (Notice)	\$250	\$150 (Renewal effective upon filing)	\$0
Virginia	\$500	\$250 (Effective date assigned)	\$100
Washington	\$600	\$100 Online (Effective date assigned)	\$100
Wisconsin (Notice)	\$400	\$400 (WI does not do renewals, they do re-registration, will have a new registration # each year.) (Re-registration effective upon filing)	\$200
Florida	\$100 (annual)		
Kentucky	\$150 (one time)		
Nebraska	\$100 (one time)		
Texas	\$25 (one time)		
Utah	\$100 (annual)		

The FTC Disclosure Rule

- The FTC rule requires delivery of Franchise Disclosure Document to a prospect at least 14 calendar days prior to signing a franchise agreement or payment of money (certain state exceptions)
 - Day delivered doesn't count

Exception 1

New York
Oklahoma
Rhode Island

Provide the FDD to a prospective franchisee at the earlier of (i) your 1st personal meeting held to discuss the franchise or (ii) **10 business days** before any agreements are signed or any monies paid (including fully refundable deposits)

Exceptions 2 & 3

Michigan Oregon	Provide the FDD to a prospective franchisee <u>10 business days</u> before any agreements are signed or any monies paid (including fully refundable deposits)
Iowa	Provide the FDD to a prospective franchisee at the earlier of: (i) your 1st personal meeting held to discuss the franchise; or (ii) <u>14 calendar days</u> before executing a contract or paying any consideration.

2017 Federal Holidays

DATE CELEBRATED	HOLIDAY
Monday, January 2	New Year's Day (observed)
Monday, January 16	Birthday of Martin Luther King, Jr.
Monday, February 20	President's Day
Monday, May 29	Memorial Day
Tuesday, July 4	Independence Day
Monday, September 4	Labor Day
Monday, October 9	Columbus Day
Friday, November 10	Veterans Day (observed)
Thursday, November 23	Thanksgiving Day
Monday, December 25	Christmas Day

Additional Timing Concerns

Fill-In-The-Blank Provisions

To the extent that substantive contractual details – such as geographic area of a protected territory and interest rates – are not disclosed in the basic disclosure document or its attachments, then the completed document must be disclosed (7) seven calendar days before signing. 72 Fed. Reg. 15471 n.277

Fill-In-The-Blank Cont.

A provision in the FDD which specifies a standard territory but leaves which one to question does not trigger the 7 day rule, but it must be sufficiently descriptive.

“We assign protected territories by county. Your protected territory will be [name of county], in [state].” - Sufficient

“the protected territory will range from 1 to 10 miles” – Insufficient triggers the 7 day rule

Additional Timing Concerns

Sometimes franchisees take a while to finalize their plans and commit. Be certain that, if you have made amendments or updates since your franchisee received the disclosure document, that you provide the franchisee with the NEW disclosure document BEFORE signing.

FDD

Disclosure Document

- One document used to comply with FTC Rule
- Addenda to comply with each state's registration requirements
- Exhibit F - State-Specific Disclosures and Riders – Need to be signed when FA is signed

“Prospective Franchisee”

Any person who approaches or is approached by a franchisor or franchise broker, or any of its representative or agents, for the purpose of discussing the establishment, or possible establishment, of a franchise relationship involving such person

- Pre-Qualification

Who Receives an FDD?

- Those purchasing an interest
- Choices
 - Individual(s)
 - Corporate entity
- Best Choice
 - All individual persons who will have any interest in the Franchise

Electronic Delivery?

- Electronic
 - Need to Inform Prospect
 - Software necessary to download
 - Will provide paper copy upon request
 - Decline (request paper copy)
 - 14 calendar days does not start until paper copy received
- No separate Item 23 Receipt – Must print FDD
- Receipt Must Identify Salespersons

Some Third Party programs that will provide electronic receipts

- Microsoft Dynamics CRM and DocuSign (integrated)
- [SalesForce.com and DocuSign \(integrated\)](#)
- IFX Online
- Naranga

You may also provide the FDD in pdf format via email, provided that you comply with the e-disclosure requirements on the previous slide.

Avoid Disclosure Errors

- No FDD receipt
- Statement contrary to FDD
 - IMPORTANT – Do not interpret something stated in the FDD or the Agreements for a Franchisee WITHOUT your attorney providing a WRITTEN legal opinion.
- Sloppy record keeping
 - Who signed?
 - Dated?
 - First possible date for Signing or Paying Calendared?

Disclosure Quiz #1

- Salesperson Sam has been chatting on the phone with Joe about a possible franchise, and Joe tells Sam that he and his partners Bob and Bill are going to form an LLC for the franchise. Who does the FDD go to?

Disclosure Answer #1

- Joe
- Bob
- Bill
- And LLC if formed
 - Get signed receipts from all!!!

Disclosure Quiz #2

- What information does Salesperson Sam need before providing the FDD and continuing discussions?

Disclosure Answer #2

- Where do all 3 partners live?
- Where will LLC be formed?
- Where will proposed Franchise Operate?
- Can you sell in Each State: live, LLC, Operate?
 - If no, call Legal before any further discussions
- Is the proposed territory available?
- ALL 3 Partners need to be Pre-Qualified
- Personal Financial Statement for Joe, Bob and Bill
- Are either Joe, Bob, or Bill married?
- If so, you should look at joint assets v. singular assets

Disclosure Quiz #3

- What does Salesperson Sam need to do before the Company will sign a Franchise Agreement?

Disclosure Answer #3

- Follow your Pre-Qualification Procedures
- Make sure all 3 partners meet the pre-qualification requirements
- Make sure we have a signed receipt for the FDD from each partner and the TIME has passed
- Formation Documents AND Operating Agreement for the Entity
- Signed Personal Guarantees by Each Partner and Spouse

Disclosure Quiz #4

Sam decides that the easiest way to deliver the FDD is by email. He sends Joe, Bob and Bill an email that says:

“Dear Joe, Bob and Bill,

We appreciate your interest in our franchise. Thank you for sending your application and financial statements. As we discussed, the next step is for you to review our Franchise Disclosure Document. It is attached hereto. I have also attached a receipt for the FDD. Please print the receipt, sign and date it and return it to me. Please give me a call at any time with questions. Sincerely,
Sam”

- Are there any problems with this disclosure?

Disclosure Answer #4 – pt 1

Yes, there are problems. While electronic disclosure is allowed, and Sam can send the FDD by email, he needs to do the following:

- State the format of the FDD and what program is needed to view it. “The FDD is an Adobe PDF. You will need Adobe Reader to view the FDD. If you don’t have it, you can download it for free at <http://get.adobe.com/reader/>

Disclosure Answer #4 – pt 2

- Also tell them that they can have a paper copy: “If you would prefer to have a paper copy of the FDD delivered to you instead of the pdf, please give me a call or send me an email, and I will make arrangements to deliver it to you.”
- Cannot attach a separate receipt: “Please open the FDD and review. The last page of the FDD is a receipt acknowledging that you received the FDD. Please print the receipt, sign, date it the date you received the FDD and return it to me by mail, email or fax.”

Sample Email/PDF Disclosure

Dear XXXX[Name of Franchise Applicant]:

We appreciate your interest in our franchise. Thank you for sending your application and financial statements. As we discussed, the next step is for you to review our Franchise Disclosure Document (“FDD”). It is attached hereto. The FDD is an Adobe PDF. You will need Adobe Reader to view the FDD. If you don’t have it, you can download it for free at <http://get.adobe.com/reader/>.

Please open the FDD and review. The last page of the FDD is a receipt acknowledging that you received the FDD. Please print the receipt, sign, date it the date you received the FDD and return it to me by mail, email or fax. If you would prefer to have a paper copy of the FDD delivered to you instead of the pdf, please give me a call or send me an email, and I will make arrangements to deliver it to you. Please give me a call at any time with questions.

Disclosure Quiz #5

Joe and Bob email their receipts back dated 1/9/17, but Bill asks for a paper copy of the FDD, when can we sign a Franchise Agreement?

Disclosure Answer #5

You can't sign an agreement yet. You will need to deliver Bill's paper copy of the FDD by mail, UPS or other delivery and wait for his signed receipt. Would always recommend that if delivering a paper copy, you include a pre-addressed, postage pre-paid envelope for return of the receipt.

Disclosure Quiz #6

Suppose Joe, Bob and Bill all live in Michigan and they all send their FDD receipts back dated Friday, October 6, 2017. When can we sign a franchise agreement?

Disclosure Answer #6

Tuesday, October 24, 2017. In Michigan, you must provide the FDD 10 business days before signing. Don't count Weekends and don't count federal holidays (Monday, October 9, 2016 - Columbus Day). Also, don't count the day it was delivered. Start counting the next day.

Disclosure Quiz #7

Joe, Bob and Bill are interested in opening a store in McAllen, Texas. Sam tells Joe, Bob and Bill that McAllen, Texas is such a great territory that he has 3 other potential franchisees looking at it and that it will go to the first one to sign and pay. Joe, Bob and Bill just got their FDD yesterday, but they don't want to lose this territory. They offer to pay a deposit to hold the territory until they can sign a franchise agreement. Sam says "sure, your deposit will be 100% fully refundable if you decide not to sign a franchise agreement. I'll just hold it until the 14 days are up, and you guys let me know what you want to do."

- Any problems?

Disclosure Answer #7

Big Problems!!

- Don't ever tell a franchisee that you believe a specific territory is a "Great" territory.
- You cannot receive any funds from the franchisee until the requisite time frame has passed from the receipt of the FDD – even fully refundable deposits!

Disclosure Quiz #8

Bob and Bill back out of the deal with Joe. Joe tells Sam that he really wants to open a franchise, but he only has funds for 50% and needs a partner. Franchisor has had a great year of sales and has money for expansion. Owner of Franchisor agrees to be a 50% partner with Joe. Since Joe and Owner are going to be partners, we don't have to comply with disclosure laws, right?

Disclosure Answer #8

Wrong. Partners are franchisees. Even though Joe will be a partner, we must provide him an FDD and follow all the FTC and applicable state laws in our dealings with Joe.

Update Material Changes

What is Material?

These terms shall include any fact, circumstance, or set of conditions which has a substantial likelihood of influencing a reasonable franchisee or a reasonable prospective franchisee in the making of a significant decision relating to a named franchise business or which has any significant financial impact on a franchisee or prospective franchisee.

Material Change Examples

- New or departing executives
- The filing of, or decision in, litigation required to be disclosed in Item 3
- Any recent developments that could create significant operating problems for franchisees
- Any significant change in franchise program, including training and advertising requirements, terms of financing arrangement, and supplier rules (including rebates)
- Significant adverse change in franchisor's financial condition
- Termination, closing, failure to renew or repurchase of a significant number of franchises (Item 20)

Other Update Requirements

- **Must include interim unaudited financial statements as soon as possible following the close of each quarter.**
- In Maryland, you must file a quarterly report identifying franchises sold in the state
- In California, you must complete a negotiated sales form AND update the CA FDD disclosures any time you negotiate any provisions in the FA with a new CA franchisee.
- Any time you create new franchise advertising (not advertising to consumers), you need to consult legal about whether the advertising needs to be registered.

Financial Performance Representations

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.

Financial Performance Representations

- GENERAL RULE: Unless a Financial Performance Representation is in the confines of Item 19 of the Franchise Disclosure Document- - Franchisor **CANNOT** make any financial performance representation
- Any disclosure outside of representations contained in Item 19 is a violation of the FTC Rule

FPR Quiz

Which if Any of These Statements are
“Financial Performance Representations”?

FPR Quiz

- You can earn a \$1 million profit per year
- Here's a copy of our most recent press release
- One franchisee had sales volumes of \$100,000 last year
- Earn enough money from your business to pay for your son's college tuition
- Cost of goods sold is approximately 40% of gross revenue

FPR Quiz

- Buy a new Mercedes with your profits
- This business will make big money
- Figure a 10% return on your investment
- Tell me what you think you can make and I'll let you know if it's realistic
- 1/3 of your sales will be gross profit
- The financial projections which you prepared and asked me to comment on look realistic

FPR Answer

You guessed it – Each and every one of those statements is a financial performance representation. They are forbidden!

Which Laws Apply?

- When does a particular state's law apply?
 - Where does the prospect live?
 - What territory will be covered?
 - Where are discussions/negotiations held?
 - Where will the franchisee's principal place of business be located?

Laws re Broker registration

Salesperson

Salesperson registration

Broker

Any person other than a franchisor who sells, offers for sale, or arranges for the sale of a franchise

(separate registration in NY and WA)

Advertising for Franchise?

- Required filing in some registration states before use
 - **Exception:** Newspaper or publication of general circulation with more than 2/3 of circulation outside state
- Should be reviewed by counsel, sent to states before production
- “Advertisement” includes any written or printed communication, or any communication by means of recorded telephone messages or spoken on radio, television, or similar communications media, published in connection with an offer or sale of a franchise.

Advertising Registration Laws

California	3 business days
Maryland	5 business days
Minnesota	5 business days
New York	7 days
North Dakota	5 business days
Rhode Island	5 business days
Washington	7 days

What Can Go Wrong in Adv?

- Misleading
- Profit or “success” assurances
- Excessive claims
- FPR
- Missing legends

Advertising Ex. #1

A prominent franchisor with a substantial number of franchise units and which collects financial data from each of its units, had an Item 19 FPR in its FDD which included the average unit sales volumes for its franchise locations. Franchisor decides to run a franchise sales add in the Wall Street Journal. The add accurately describes the Franchise and states the average unit volumes of franchisees. Any problems?

Advertising Ans #1

Yes. There are several problems, but let's talk about what they did right first:

- The add is accurate and truthful
- The FPR in the add is consistent with Item 19
- The Franchisor had a reasonable basis for making the FPR representations in the Ad.

Advertising Ans #1 Cont.

Now for the problems:

- The Add did not contain the required FTC disclaimer
- The Add did not list the number of franchise units, and the percentage of units which exceeded or were below the Average.
- The Add did not identify any characteristics of the units which might make them different from the franchises to be offered.

The FTC Advertising Disclaimer

Just like in Item 19 of the FDD, the Add must include a prominent disclaimer:

The financial performance representations made herein reflect the historical performance of existing franchisees. New franchisees' individual financial results may differ from the results stated herein. Written substantiation for the representations made herein are available upon reasonable request.

Negotiated Deals

- Prospective franchisees will ask for change to the standard deal
- Negotiations may facilitate sales but also can:
 - Involve anti-discrimination laws
 - Cause dissension among franchisees who did not get the best deal
 - Require disclosure of pattern of negotiation

If You Negotiate a Deal:

- Properly document modification – last-minute amendments are often subject of disputes
- Amend FDD if necessary
- Negotiated Change Filing in CA

Franchise Relationship Laws

- Covers
 - Terminations
 - Renewal
 - Transfers
 - Discrimination

Regulation of Termination

- Good Cause
- Notice of Termination
- Opportunity to Cure Default
- Termination Without Opportunity to Cure

Franchise Relationship Laws

Arkansas
California
Connecticut
Delaware
District of Columbia
Hawaii
Idaho
Illinois
Indiana
Iowa
Kentucky
Maryland

Michigan
Minnesota
Mississippi
Missouri
Nebraska
New Jersey
South Dakota
Tennessee
Virginia
Washington
Wisconsin

Refusal to Renew

- Good cause
- Notice of non-renewal

States that Restrict Franchisor Rights in Franchisee Transfers

Arkansas

California

Hawaii

Indiana

Iowa

Michigan

Minnesota

Nebraska

New Jersey

SBA Limits on Franchisor Control

- SBA requires every Franchisor, where the Franchisee is receiving SBA Financing to sign the standard SBA Addendum.
- Transfers of Ownership of the Franchisee: The franchisor cannot own an interest in the franchisee, so it will agree not to exercise its right of first refusal in connection with a transfer of partial ownership interests. Also, the franchisor will agree not to unreasonably withhold its consent to such a transfer.
- Franchisor's Option to Purchase: If the franchisor exercises an option to purchase the franchisee's assets but there is disagreement on the purchase price, the value must be determined by an appraiser chosen by the franchisor and franchisee.
- Real Estate: The franchisor's purchase option cannot include real estate if the franchisee owns the premises, but the franchisor can require the franchisee to lease the real estate to the franchisor for the remainder of the franchise term for a fair market value rent. The franchisor cannot record against the real estate any restrictions on the use of the property, such as restrictive covenants, branding covenants, or environmental-use covenants.
- Employment Matters: The franchisor cannot directly control the franchisee's employees, by, for instance, hiring, firing, or scheduling the employees.

States with Anti-Discrimination Statutes

Hawaii

Illinois

Indiana

Iowa

Minnesota

Washington

Discrimination Statutes

Hawaii, Illinois, Minnesota and Washington	Fees, Royalty, Goods, Services, Equipment, Rentals, Advertising Services, Etc.
Indiana	Unfair Discrimination
Iowa	Unfair Discrimination Against Proposed Transferee

Consequences in Registration States Of Failing to Comply with Disclosure

Laws

- Damages
- Rescission
- Attorneys' fees
- Negative FDD disclosures
- Criminal fines and prison sentences
- Personal liability



Violations of IL Franchise Law

- Civil penalties up to \$50,000 per violation
- Criminal prosecution
- Private right of action
 - Damages
 - Rescission
- State will hold up registration and require rescission offers and fines upon discovering violation

Consequences for Violation of FTC

- Civil penalties up to \$11,000 per violation
- FTC may bring an action in federal or state court for damages on behalf of franchisees
- No private right of action, but violation of FTC is generally enough to establish violation of most states' little FTC acts or unfair competition statutes
- FTC can impose penalties for BOTH advertising violations and disclosure violations.

State Little FTC Acts

- Modeled after FTC Act
- Relief from “unfair or deceptive practices”
- Proof of actual injury or intent not required in some states
- Damages
 - Varies from state to state
 - Injunctions and attorneys’ fees
 - Punitive and treble damages for intentional or reckless conduct

Personal Liability

Every partner in a firm so liable, every principal executive officer or director of a corporation so liable, every person occupying a similar status or performing similar functions, every employee of a person so liable who materially aids in the act or transaction constituting the violation, are also liable jointly and severally with and to the same extent as such person, unless the other person who is so liable had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability is alleged to exist.

Practical Consequences of Non-Compliance

- Might decide not to move forward with prospect due to risk
- Gives complaining franchisee a bargaining chip
 - Franchisee's failure unrelated to franchise laws
 - Looking for scapegoat
 - “Deck is stacked against you”
- Holds up state registration filings, fines

Good Record Keeping

You need to have staff and/or technology in place to make sure you have good records.

Some non-smart, manual forms are available on our website

Some companies with contract management software are:

- FRM Solutions: <http://www.frmsolutions.com/>

Stan Freidman at sfriedman@frmsolutions.com

- IFX Online: www.ifxonline.com

Dan at dan@ifxonline.com

- Fran Connect: