

Franchise Regulations

and the FDD

Franchise laws and regulations are in place for the benefit of persons considering buying a franchise, generally referred to as a prospective franchisee. FranNet wants our clients to understand these laws and regulations.

U.S. Federal law requires that a franchisor deliver to a prospective franchisee a current copy of the 75- to 200-page document known as the **Franchise Disclosure Document (FDD)** at least 14 calendar days before the prospective franchisee signs any binding contract or commitment, or makes any payments to the franchisor. Finally, the franchise contract, with all blanks filled in, must be in the possession of the prospect at least five business days before the prospective franchisee signs it.

WHAT IS A FRANCHISE?

A franchise enables you, the prospective franchisee, to operate a business under the franchisor's trademark. You pay a franchise fee and you receive training in, and the right to use, a business system developed by the franchisor.

The purchase of a franchise is an investment in a long-term business license to use the franchisor's name and systems. The franchisor provides training and ongoing assistance. The franchisor grants you a license to distribute goods and/or services using the company's trademarks, trade names, trade styles and business systems. It is a complete system of doing business. Indeed, the word "system" is the key concept in franchising.

A franchisee usually receives assistance with site selection, personnel training, technical training, business set-up, advertising, product supply, merchandising, customer relations, etc. The franchisor will have operations manuals and training programs in place to teach the business systems to the new franchisee.

Put simply, a franchisee is investing in a license that gives access to someone else's expertise, experience, and method of doing business.

However, a franchise is a special kind of business license because during the term of the franchise, the franchisor has significant control on the franchisee's business operations, and provides significant assistance.

A FRANCHISE DISCLOSURE DOCUMENT INCLUDES:

1. **History:** This item provides a brief history and description of the franchisor, its predecessors, affiliates, officers and their business experience. Note when the company was founded and when it started selling franchises.
2. **Business Experience:** This section provides a 5-year employment history on the franchisor's officers, directors, and those with management responsibility relating to the sale or operation of the franchise.

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3. **Litigation:** Describes any pending or past litigation involving: violation of franchise, antitrust, or securities laws; lawsuits alleging fraud or similar allegations; or any lawsuits between the franchisor and franchisees. Item 3 may put you on notice about potential claims against the franchisor that might have an impact on your decision to purchase a franchise from that franchisor.

4. **Bankruptcy:** If the franchisor or any of its key executives have filed for bankruptcy in the past 10 years, it must be disclosed here.

5. **Initial Franchise Fees:** This item describes all fees paid to the franchisor before the franchisee opens for business, including the initial franchise fee, and discloses whether any of the fees are refundable.

6. **Royalty & Other Fees:** This table lists all fees paid to the franchisor during the term of the franchise agreement, including royalty fees, advertising fees, transfer fees, etc.

7. **Initial Investment:** This table contains a range of all fees and costs you may incur in starting the franchised business and operating it for an initial period (usually 3 months). List all the money you'll have to spend to become a franchisee, from paying the franchise fee through your grand opening, and to stay afloat for the first three months.

8. **Restrictions on Sources of Products & Services:** To ensure consistency, franchisors usually limit the sources of products and services you can use. This item describes what products, services or equipment must be purchased from the franchisor or its designated supplier. It also discloses whether or not the franchisor receives payments as a result of your purchase of products or services from designated suppliers.

9. **Franchisee's Obligations:** Contains a chart listing franchisee's obligations, and where they are found in the franchise contract.

10. **Financing:** This item describes any financing provided by the franchisor, and the terms of such financing. Many franchisors say they offer some type of financing to help to new franchisees, but what they offer ranges from financing part of your investment themselves to giving you the phone numbers of bankers with whom they have relationships. It is usually recommended that you go over this section with your own lawyer and accountant.

11. **Franchisor Assistance:** This item describes the franchisor's obligations for training and ongoing assistance. It also describes advertising programs and requirements, and computer and POS requirements.

12. **Territory:** This section states whether or not you will operate your franchise within an exclusive territory. If the system provides protected territories, Item 12 describes their parameters.

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13. **Trademarks:** One of the greatest advantages of a franchise is its brand. This item lists the franchisor's trademarks that are licensed to franchisees, and indicates whether or not they are federally registered.

14. **Patents, Copyrights & Proprietary Info:** This item discloses whether or not the franchisor has any patents or copyrights material to the operation of the franchised business.

15. **Obligation to Participate in the Actual Operation of the Franchise Business:** This explains whether franchisors require franchise owners to operate their franchises themselves. Some systems require you to run your franchise yourself; others allow passive investors who can hire managers to handle the day-to-day operations.

16. **Restrictions on What the Franchisee May Sell:** To provide consistency, franchisees usually must all sell the same items. Restrictions listed in this item are unique to each franchise system.

17. **Renewal, Termination, Transfer and Dispute Resolution:** This item contains a chart with a summary of what happens when your contract expires and you want to renew it, or when you want to sell your franchise. It also describes how disagreements with the franchisor will be settled or adjudicated.

18. **Public Figures:** This item describes whether or not the franchisor uses a public figure to promote its franchises, and the terms of such any compensation paid to the public figure.

19. **Financial Performance Representations:** Over 85% of franchisors provide information on how much their current franchisees are earning, or make other financial performance representations. The others provide a single sentence: "We do not make earnings claims." Ask why.

20. **List of Franchise Outlets:** Shows the number of franchises opened, transferred and closed in the last three years and lets you know if the franchise is growing or shrinking.

21. **Financial Statements:** Franchisors must provide 3 years of audited financials. If a franchise is less than 3 years old, they must provide audited statements for each of the years they have been in business. A franchise that has not been in business for at least 1 year provides an audited starting Balance Sheet.

22. **Contracts:** Lists all contracts you may be required to execute in conjunction with becoming a franchisee, including the actual Franchise Agreement contract and other contracts covering personal guarantees, real estate assignments, advertising, co-op rules and conditions, and territorial development schedules.

23. **Receipt:** The last page of the FDD is a receipt page for the franchisee to sign to document when the FDD was received.