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AMENDED FTC FRANCHISE RULE RELEASED - FINALLY!

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After a gestation process which spanned most of two decades, the Federal Trade Commission ("FTC") published its Amended Franchising Rule on January 23, 2007.

The new disclosures may be used effective July 1, 2007, and they must be used for all franchises offered or sold after July 1, 2008. The Amended Rule prescribes a disclosure format which largely mirrors the Uniform Franchise Offering Circular ("UFOC") format, and modifies it in certain places by adding new disclosures. The Commission plans to publish Compliance Guidelines, which will use the current UFOC Guidelines as their point of departure.

Franchisors will find many things to like about the Amended Rule. Requirements related to the delivery of disclosures will be welcomed by all, while exemptions for high investment franchises and for sales to certain high net worth franchisees will eliminate compliance obligations altogether for some franchisors. Franchisors will be allowed to use electronic means to deliver disclosure documents. Financial Performance Representations (*i.e.*, earnings claims) remain optional, not mandatory. New franchisors may continue to phase into the financial audit requirement if they have not previously had audits.

The Amended Rule has addressed many of the concerns raised by the franchising community since the Revised Proposed Rule was issued in 1999. For example, thresholds for large investment franchises have been lowered, and the number of franchisor employees who are entitled to qualify for a new exemption have been expanded. Franchisee advocates will appreciate added prohibitions concerning the use of merger and integration clauses to deflect liability for disclosures made in offering circulars. They also will like several new disclosure requirements relating to franchisor initiated litigation, franchisor uses of confidentiality clauses, and the identification of franchisee associations, and they should like being able to negotiate amendments to franchise agreements at a closing without being subject to a five (5) business day delay.

New Exemptions

The Amended Rule creates several new exemptions, including exemptions for:

1. The sale of franchises to be located outside the United States;
2. Franchises involving investments of at least \$1 million (excluding unimproved land and amounts financed by the franchisor). This initial investment would be calculated to include multi-unit development commitments, and the value of a business which is converted to a franchise through an affiliation franchise agreement;
3. Investments by high net worth, experienced franchisees –those with five (5) years of business experience and a net worth of at least \$5 million; and
4. Sales to certain officers, owners and managers of franchisors.

No More Broker Disclosures or Venue/Law Choice Risk Factors

Franchisors which use franchise brokers, especially those with broker networks, will find that their burdens are relaxed considerably, as disclosures about franchise brokers no longer are required. The UFOC's required use of "risk factors" based upon a franchisor's choice of law or venue for disputes no longer will be required either.

Timing and Delivery of Disclosures Simplified

The rules for when disclosures must be given to prospective franchisees also provide a welcome change. The duty to provide a disclosure at the "first personal meeting" has been deleted, and the cumbersome 10 business day counting problem has been eliminated. Now, disclosures must be provided 14 calendar days before the franchisee makes a payment to the franchisor or an affiliate in connection with a franchise purchase, or 14 calendar days before the franchisee signs a franchise related agreement. However, if a prospective franchisee "reasonably requests" a disclosure document earlier than 14 days before the agreement is signed or money is paid, he is entitled to receive it earlier. It is not clear what will happen if the franchisor does not have a disclosure document completed which it can deliver at the time of the prospective franchisee's request. Completed agreements must be provided to prospects seven (7) days before signing, but only if the franchisor has unilaterally made a change to the standard form agreement provided with the disclosure document. The five business day cooling off period for review of modification to franchise agreements has been eliminated.

Disclosure documents may be delivered in electronic form without any of the accompanying notices required in earlier drafts of the Proposed Rule. Franchisors must simply explain how a prospective franchisee may download or access the disclosure document. The Amended Rule even creates a presumption that paper or tangible copies of an electronic disclosure are received three (3) days after they have been mailed with the proper postage and address.

New Disclosure Highlights

The new disclosure requirements include:

1. Information about the franchisor's parent in items 1, 3 and 4. Financial statements of the parent must be included if the parent will provide services to franchisees or if a parent guarantees obligations of the franchisor. Disclosures about franchisor's predecessors and affiliates remain.
2. Information about franchisor-initiated litigation against franchisees. Disclosure must cover the franchisor's previous fiscal year only, and they may be made in summary form. Much less detail is required than exists when franchisors are defendants in franchisee originated claims.
3. Information about the franchisor's use of confidentiality clauses must be spelled out so as to inform prospective franchisees that some of the franchisees they contact may be prohibited from disclosing full details of questions they may be asked about their franchisors.
4. Information about the existence of "trademark-specific franchisee associations;" which have requested that their identities be placed in UFOCs and
5. Franchisee turnover information will be presented in a way which will substantially reduce the likelihood of "double counting" transfers and terminations.

New Prohibitions

The Amended Rule contains several new prohibitions. Franchisors may no longer require a prospective franchisee to waive reliance on any representation made in a disclosure document, its exhibits or amendments. The use of "skills" to promote franchises also is prohibited.

Conclusion

The Amended Rule is part of a 398 page document, which contains the details with which franchisors and their lawyers will need to become familiar to meet the new requirements. Still unknown is exactly how quickly states with franchise registration laws will be able to adapt to the changes, and the extent to which they will require information which differs from what is included in the Amended Rule. State franchise laws in 15 states allow use of the UFOC to satisfy their disclosure requirements. Regulations may be required to permit use of the FTC prescribed documents. Also, many states have adopted the current FTC presale disclosure timing requirements (first personal meeting, 10 business days, 5 business days , and regulations or statutes may need to be amended to permit compliance with the new FTC standards.

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