

Long awaited Amended Franchising Rule arrives

Since the early 1990s, the franchising community has awaited changes to the U.S. Federal Trade Commission's Franchising Trade Regulation Rule. On January 23, 2007, the FTC finally published its Amended Franchising Rule.

GUEST COLUMN

CARL E.
ZWISLER
&
JAN S.
GILBERT

The new disclosures may be used as of July 1, 2007, and they must be used for all franchises offered or sold after July 1, 2008. The Amended Rule requires franchisors to use a disclosure format, which is, in essence, a modification of the Uniform Franchise Offering Circular format. The FTC plans to publish Compliance Guidelines this spring, which should contain instructions for preparing disclosure documents and clarifying ambiguities in the Amended Rule.

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 deliver disclosure documents electronically. Financial performance representations (earnings claims) remain optional, rather than 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 business day cooling off period before final franchise agreements may be signed.

New exemptions

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

- The sale of franchises to be located outside the United States
- 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
- Investments by high net worth, experienced franchisees: those with five years of business experience and a net worth of at least \$5 million
- Sales to certain officers, owners and managers of franchisors

No more broker disclosures or venue/law choice risk factors

Franchisors that use franchise brokers, especially those that retain 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, 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 days before signing, but only if the franchisor has unilaterally made a change to the standard form agreements which have been provided with the disclosure document. The five-business day cooling off period for review of modification to franchise agreements has been eliminated.

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 "shills" to promote franchises also is prohibited.

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 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, six states have adopted the current FTC presale disclosure timing requirements (first personal meeting, 10 business days), and regulations or statutes may need to be amended to permit compliance with the new standards.

Carl E. Zwisler and Jan S. Gilbert are attorneys in the Washington, D.C., office of Haynes and Boone LLP. They both focus on franchising law and have been involved with the International Franchise Association. Zwisler participated in the development of both the initial FTC Rule and the Amended Rule. He can be reached at carl.zwisler@haynesboone.com. Gilbert can be reached at jan.gilbert@haynesboone.com.