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FTC Makes Sweeping Changes In Franchisor-Franchisee Disclosure Rules: Franchisors Must Comply With The Revised Law By July 1, 2008

For the first time in almost 30 years, the Federal Trade Commission has amended the rules governing the relationship between franchisors and franchisees. The changes reduce the disclosure requirements for high-end investors and franchisees, while still protecting smaller entrepreneurs with fairly demanding disclosure rules.

The new rule makes revisions to almost every Uniform Franchise Offering Circular (“UFOC”) disclosure item required in that document.

Initially, stringent disclosures need not be made to “sophisticated investors”—applicants who make an initial payment of \$1,000,000 or more, who have been in business for five or more years, who have a net worth of \$5,000,000 or greater or who are insiders who were owners or managers within the franchise system before.

Franchise applicants who are not “sophisticated investors” will receive an expanded disclosure form from the franchisor which must include disclosure of “material” franchisor-initiated litigation over the past year, as well as previous confidential legal settlements between the franchisor and franchisees.

However, the new rule increases requirements for franchisors in some areas. For example, the disclosure document must contain a description of the franchisors’ renewal policy and whether renewal entails a requirement that the franchisee execute a new or different franchise agreement. The most significant change in the disclosure requirements relate to disclosure of the number of store outlets and the changes in that number over the last three years.

In addition, the disclosure document must contain disclosures of the existence of confidentiality clauses, if any. This is done basically to put prospects on notice that not all franchisees will be allowed to respond to inquiries from a new prospect.

Other aspects of the new rule have yet to be determined. For example, while disclosures have been curtailed, the definition of a “parent” has been broadened to focus on control rather than ownership. This means that some “parent” companies who in the past were not required to make disclosures, may now find that disclosures are mandated.

The new rule also includes some procedural changes which should make disclosure easier for franchisors. The disclosure document now may be delivered via hard copy, CD ROM, e-mail or Website download. The document must be delivered no later than 14 calendar days before the franchisee signs any agreement or pays any money to the franchisor. The FTC also lengthened the time period for annual updating the disclosure document from 90 to 120 days.

This amendment is a significant step towards reducing presumably needless disclosure requirements, especially as those relate to larger investors in franchise operations. However, the new rule also creates potential pitfalls for the unwary franchisor. Becoming familiar with the ins and outs of compliance with the new rule is critical to any company involved in the business of franchising.

Womble Carlyle’s team of experienced attorneys is available, should you have any questions or wish to discuss these far-reaching changes: Jerry Boykin (703) 394-2211, [email](#), Carol Brani (919) 755-8139, [email](#) or Stan Smith (404) 888-7451, [email](#).

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