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## Franchising Legal Issues Summary

Franchising as a Business. Franchising is a major component of all business conducted in the United States. The International Franchise Association (IFA – [www.franchise.org](http://www.franchise.org)) reports that franchising spans 75 industries and constitutes more than half of some business lines. Franchising offers the seller a means of expanding its distribution network while providing the buyer with a business system and brand to facilitate its business operations.

Franchising Resources and Requirements. The IFA and the U.S. Federal Trade Commission (FTC – [www.ftc.gov](http://www.ftc.gov)) offer helpful franchising publications (see Resources below). Under its Franchise Rule, the FTC requires franchisors to deliver an extensive disclosure document called a Franchise Disclosure Document (FDD formerly known as a UFOC) at least 14 days before accepting money or a legal commitment from a prospective franchisee. Both the IFA and the FTC recommend that franchisees have their attorney review the FDD and the franchising agreement. This 14-day waiting period permits time for review.

Disclosure Requirements. The disclosure required by the franchisor in the FDD includes:

- the total number of franchises, and the number of franchises terminated or not renewed during the last three fiscal years;
- the bases and assumptions for any claims about potential earnings or the earnings of existing franchisees;
- the estimated costs of starting and maintaining the business;
- the names, addresses and telephone numbers of current franchisees;
- the background and business experience of the franchisor's key management personnel;
- an audited financial statement of the franchisor;
- any lawsuits against the franchisor or its directors by franchisees; and
- the responsibilities of the franchisee and the franchisor if the franchise is purchased.

Franchise Agreement. The FDD will include a franchise agreement - a lengthy, complex contract between you and the franchisor. It is written by the franchisor's attorney to protect the franchisor. Although franchisees are frequently told that the franchise agreement is non-negotiable, that is seldom the case. An experienced franchise attorney can help you understand and negotiate more favorable terms. As a franchisee, it is important to understand:

- What is your personal liability to the franchisor and others if you form a corporation or LLC to operate the franchise?
- Are you obligated to purchase products, services or supplies from the franchisor or its affiliates? At what price?
- Are you protected from competition by the franchisor or other franchisees?
- What are the transfer restrictions on your corporate or LLC ownership interest? Does the franchisor have a "right of first refusal" to purchase the interest before it is transferred?

- Under what conditions may you renew the franchise? Is it renewable for the entire area you developed? Can the franchisor modify the franchise agreement terms on renewal?
- Can the franchisee terminate the franchise agreement and its future payment obligations? Is termination permitted only “for cause” and how is “cause” defined?
- For what reasons may the franchisor terminate the franchise? Do your obligations also terminate? Does the franchisor have the right or obligation to repurchase franchise-related supplies and materials? At what price? Do you remain personally liable on any equipment or premises leases?

Other Legal Issues. Other common legal requirements in franchising include:

- Creating a corporation or LLC to protect your personal assets from liabilities arising from franchise operations.
- Preparing the corporate or LLC organizational documents to include provisions required by the franchise agreement.
- Preparing shareholder or ownership agreements as required by the franchise agreement.
- Negotiating and reviewing lease terms, including any provisions required by the franchise agreement.

### FTC Resources

Buying a Franchise: A Consumer Guide

<http://www.ftc.gov/bcp/edu/pubs/consumer/invest/inv05.shtm>

Amended Franchise Rule

<http://www.ftc.gov/opa/2007/01/franchiserule.shtm>

### IFA Resources

Frequently Asked Questions About Franchising

<http://www.franchise.org/industrysecondary.aspx?id=10008>

Franchising Economic Outlook

<http://www.franchise.org/Franchise-News-Detail.aspx?id=43596>

<p>Just as there is no standard “form” of franchise agreement, there is no standard set of issues for franchises. This summary is intended only to be an introduction and to urge those considering a franchise to seek experienced advisors in this area.</p>
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