In Support of a New Uniform Franchise Disclosure Act; If Not Now, When?

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The centerpiece of franchise law is the concept that prospective franchisees should be given an opportunity to make an informed investment decision by receiving relevant business disclosures before making their investment.

Since 1979, the Federal Trade Commission (FTC) has required franchisors to provide prospective franchisees with a franchise disclosure document (FDD) before selling them a franchise.[1] However, if a franchise seller violates the FTC Rule, there is no private right of action, and the FTC will rarely take action on behalf of an injured franchisee.[2] In some states, laws require registration or notice of franchise offerings before sale, and these laws may provide for a private right of action for disclosure violations, or grant police powers to a state agency charged with enforcement of the law.[3] A few other states have laws that do not require registration, but which may provide a remedy to injured franchisees for disclosure violations.[4] However, a majority of states do not have any law requiring pre-sale disclosures in the sale of franchises.[5] While the FTC Rule still applies in these states, no specific statutory remedy is available to a

1. Disclosure Requirements and Prohibitions Concerning Franchising, 16 C.F.R. § 436 (FTC Franchise Rule).

2. *See, e.g.*, Freedman v. Meldy's, Inc., 587 F. Supp. 658, 661–62 (E.D. Pa. 1984) (finding that no private right of action was granted by Congress under the FTC Act and that the FTC's views regarding the desirability of a private right of action are not sufficient to create such a right in the absence of congressional action).

3. *See* Cal. Corp. Code § 31000 *et seq.;* Fla. Stat. § 817.416 *et seq.*; Haw. Rev. Stat. § 482e-1 *et seq.*; Ill. Comp. Stat. § 705/1 *et seq.;* Ind. Code § 23-2-2.5-1 *et seq.*; Md. Code Ann. Bus. Reg. § 14-201 *et seq.*; Mich. Comp. Laws § 445.1501 *et seq.*; Minn. Stat. § 80c.01 *et seq.*; N.Y. Gen. Bus. Law § 680.1 *et seq.*; N.D. Cent. Code § 51-19-01 *et seq.*; R.I. Gen. Laws § 19-28.1-1 *et seq.*; S.D. Codified Laws § 37-5a-1 *et seq.*; Va. Code § 13.1-557 *et seq.*; Wash. Rev. Code § 19.100.010 *et seq.*; Wis. Stat. § 553.01 *et seq.*

4. K.Y. Rev. Stat. § 367.801 *et seq.*; Neb. Rev. Stat. § 59-1701 *et seq.*; Ohio Rev. Code § 1334.01 *et seq.*; Or. Rev. Stat. § 650.005 *et seq.*; Tex. Bus. & Com. Code § 51.302 *et seq.*

5. Fourteen non-registration states have business opportunity laws that do not apply to sale of "franchises," and eighteen other states do not have any franchise or business opportunity

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franchisee whose franchisor fails to provide a required FDD, or provides an FDD but commits material violations of the FTC Rule in connection with its content or delivery.[6]

This article proposes to fill the gap in franchise disclosure regulation with a standardized state law that would require franchisors to provide prospective franchisees with pre-sale disclosures. A proposed act (i.e., the Uniform Franchise Disclosure Act (the Act)) for this purpose is attached at Appendix A and discussed below.

This is not the first attempt to enact a standardized state franchise disclosure law. The Uniform Franchise & Business Opportunities Act (Uniform Act) was drafted in the late 1980s, and an alternative Model Franchise Investment Act (Model Act) was proposed subsequently, but no state enacted either act.[7] Each of these proposals attracted criticism for their approach to the issue of state registration.[8] The Act proposed in this article avoids these criticisms by taking a less restrictive approach.

I. The Need for Franchise Disclosures

The FTC Rule was promulgated in 1978 after several years of public involvement through comment and hearings. In its comments supporting passage of the FTC Rule, the FTC cited congressional testimony of a former franchise executive to support the need for pre-sale disclosure requirements:

> This emotional dream, the desire of every American to own his own business, to be his own boss, has many pitfalls. He is easy prey for the hot-shot promoter because the stakes are so high here. These small businessmen very often scrape up every dime they can borrow, beg or steal in a lifetime of earnings, and put it all on one dream and hope of a franchise concept that very likely could have been misleading and fraudulent. For that reason, I think that [the government] should take some positive action to protect the small businessman. After all, he is the one that is going to get hurt, not the franchisor, because the franchisee is the one who puts up all the money and all the labor in order to develop the business concept.[9]

laws. For a more detailed discussion of these laws, *see* Stanley Dub, *What's in a Name? State Business Opportunity Statutes as Franchise Disclosure Laws*, 38 Franchise L.J. 105 (2018).

6. In states without disclosure laws, a franchisee may sometimes have a cause of action under general common law theories, such as fraud. However, such claims are often unsuited to the facts of a franchise disclosure claim. They would typically not apply, for example, to a failure to provide any disclosure document, or to a claim based on use of outdated financial statements or investment estimates in a FDD. Even where an Item 19 financial disclosure was subsequently shown to be false or misleading, a claimant relying on a fraud theory might be unable to prove the misrepresentation was intentional.

7. *See* Unif. Franchise & Bus. Opportunities Act (1987), Bus. Franchise Guide (CCH) ¶ 3600; Model Franchise Inv. Act (1990), Bus. Franchise Guide (CCH) ¶ 3700.

8. The Uniform Act would have eliminated franchise registration requirements in states that currently impose them, while the Model Act would have imposed franchise registration requirements in every state that adopted it. *See* Douglas Berry, David Byers & Daniel Oates, *State Regulation of Franchising: The Washington Experience Revisited*, 32 Seattle U. L. Rev. 811, 820–26 (2009).

9. Remarks of John V. Brown, former President of Kentucky Fried Chicken (quoted in Statement of Basis and Purpose concerning the FTC Rule, 43 Fed. Reg. 59,614, 59,626 (Dec. 21, 1978)) [hereinafter 1978 Statement of Basis and Purpose].

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The FTC Rule was amended in 2007 after further public comment and hearings. In the Statement of Basis and Purpose published with the 2007 amendments, the FTC explained the need for pre-sale disclosures as follows:

> Based upon the [1978] rulemaking record, the Commission found widespread deception in the sale of franchises and business opportunities through both material misrepresentations and nondisclosures of material facts. Specifically, the Commission found that franchisors and business opportunity sellers often made material misrepresentations about: the nature of the seller and its business operations, the costs to purchase a franchise or business opportunity and other contractual terms and conditions under which the business would operate, the success of the seller and its purchasers, and the seller's financial viability. The Commission also found other unfair or deceptive practices pervasive: franchisors' and business opportunity sellers' use of false or unsubstantiated earnings claims to lure prospective purchasers into buying a franchise or business opportunity, and franchisors' and business opportunity sellers' failure to honor promised refund requests. The Commission concluded that all of these practices led to serious economic harm to consumers.[10]

Public comments on the 2007 amendments overwhelmingly supported the continuing need for the FTC Rule.[11] The FTC sought comments again on the continued need for the FTC Rule in early 2019.[12] Forty-one comments were submitted in response, representing both franchisor and franchisee spokesmen, including comments from the International Franchise Association and the Coalition of Franchisee Associations.[13] These comments were unanimous in their support for continuation of the FTC Rule.[14]

As these comments demonstrate, support for the concept of pre-sale business disclosures in franchise transactions remains virtually unanimous today, forty years after promulgation of the original FTC Rule.

II. Federal Regulation of Franchise Disclosures Today

The FTC Rule applies to sellers of franchises if the franchise will be located anywhere in the United States.[15] As a practical matter, however, the threat of FTC enforcement is nothing more than a paper tiger. Attempts to involve the FTC in individual cases of franchise disclosure violations are rarely successful.[16] The FTC obviously lacks the resources and staff to

10. Statement of Basis and Purpose concerning the FTC Rule, 72 Fed. Reg. 15,444, 15,445 (Mar. 30, 2007) [hereinafter 2007 Statement of Basis and Purpose].

11. *Id.* at 15,447.

12. Disclosure Requirements and Prohibitions Concerning Franchising, 84 Fed. Reg. 9051 (Mar. 13, 2019).

13. Peter Lagarias & Jonathan Solish, *How Should the FTC Rule Be Restructured, If at All?*, American Bar Assoc. 42nd Annual Forum on Franchising, W-9, at 3–4 (2019), https://www.americanbar.org/content/dam/aba/events/franchising/2019_annual_meeting/w9.pdf.

14. *Id.* at 4.

15. 16 C.F.R. § 436.2.

16. In 2001, the General Accounting Office published a report on the FTC's enforcement of the Franchise Rule at the request of three U.S. senators. *See* United States General Accounting Office, *Federal Trade Commission Enforcement of the Franchise Rule* (July 2001), https://www.gao.gov/assets/240/231939.pdf [hereinafter the GAO Report]. The report covered the period

prosecute all disclosure violations nationwide, but the FTC has seemingly abdicated its role as even a *potential* enforcer of individual FTC Rule violations by failing for so long to investigate claims or bring such actions.[17] Under the circumstances, the FTC's approach to enforcement takes on a cynical aspect when viewed by injured franchisees. The FTC Rule requires that every FDD include the following: (a) an invitation on the cover page for prospective franchisees to contact the FTC for help in understanding the document; and (b) an instruction in the receipt to report Rule violations to the FTC.[18] The implication that the FTC will somehow assist franchisees injured by disclosure violations is itself a significant misrepresentation. Not uncommonly, franchisees are recent immigrants for whom English is a second language, and frequently they sign their franchise agreements without engaging an attorney to review the FDD.[19] While these franchisees must bear ultimate responsibility for their failure to get legal help, the FDD's required language implies that the FTC plays an ongoing role in protecting prospective franchisees against disclosure violations, which is simply not the case.

III. State Regulation of Franchise Disclosures

Without any hope of enforcement of the FTC Rule by the FTC, injured franchisees are left with only the remedies provided by state franchise disclosure laws, or by common-law remedies in states without franchise disclosure laws. The extent to which particular state laws or common-law remedies provide these protections is beyond the scope of this article. However, in thirty-two states, currently no law requires franchisors to provide prospective franchisees with any disclosure document.[20] Common-law remedies can be useful in cases of fraud or fraudulent misrepresentations, but those remedies reach only a fraction of the situations in which franchisees may be injured as a result of disclosure violations.[21]

between 1993 and 1999 and noted that the FTC had undertaken few FTC Rule investigations, and that roughly seven out of eight of these involved business opportunities rather than franchises. *Id.* at 3, 10–14. Among the reasons cited by FTC staff for this disparity were that "franchise cases are much more complex . . . and consume [more] law enforcement resources." *Id.* at 14. GAO also found that the FTC was more interested in complaints showing a pattern or practice of illegal conduct than in those claiming individual violations and that the vast majority of franchise complaints received involved single complaints against companies. *Id*. GAO noted in its report that "most complaints FTC receives are not investigated." *Id.*

17. *See* GAO Report, *supra* note 16.

18. 16 C.F.R. §§ 436.3(e)(4), 436.5(w)(1).

19. In an early study of the fast food industry cited by the FTC, thirty-nine percent of the franchisees did not consult an attorney before signing their franchise agreement. 1978 Statement of Basis and Purpose, 43 Fed. Reg. 59,614 n.20. More recently, an informal study of 253 franchisees found that fifty-two percent had not consulted an attorney to review their FDD or franchise agreement before buying their first franchise. Caroline Fichter, Andrew Malzahn & Adam Matheson, *Don't Tread on Me: A Defense of State Franchise Regulation*, 38 Franchise L.J. 23, 30 (2018).

20. *See* Dub, *supra* note 5 at 117.

21. *See* discussion *supra*, note 6.

IV. Previous Attempts to Enact Uniform Franchise Laws

Before promulgation of the FTC Rule in 1979, it seemed clear that no private right of action existed for violation of the FTC Act (the Act on which the FTC Rule is based).[22] However, franchisees were emboldened by the FTC's comments in the Statement of Basis and Purpose accompanying the Rule:

> The Commission believes that the courts should and will hold that any person injured by a violation of the Rule has a private right of action against the violator. . . . The existence of such a right is necessary to protect the members of the class for whose benefits the [FTC Act] was enacted . . . and is necessary to the enforcement scheme established by Congress in that Act and to the Commission's own enforcement efforts.[23]

Those beliefs and hopes were subsequently dashed, however, as courts have consistently declined to follow the FTC's express intent and imply a private right of action for violation of the Rule.[24]

Motivated by the absence of a private remedy for violation of the FTC Rule, the National Conference of Commissioners on Uniform State Laws (NCCUSL) proposed the Uniform Act in 1983.[25] After several years of debate and revision, NCCUSL approved the Uniform Act in 1987.[26] However, the Uniform Act never gained traction and was never enacted by any state. The primary objection to the Uniform Act was seemingly its intention to eliminate state franchise registration requirements.[27] States with existing franchise registration requirements were reluctant to do away with them, and franchisees in those states were unwilling to eliminate the state agency tasked with protecting their interests.[28]

The North American Securities Administrators Association (NASAA) later drafted and promoted a uniform state law. Commonly known as the Model Franchise Investment Act (Model Act), this proposal took the opposite approach on the question of registration requirements; under this law, franchisors would be *required* to register their franchise offerings in every state where they intended to do business.[29] Any state proposing to enact this statute would therefore be required to establish a new state agency with its related staff, facilities, and budget commitments. As with the Uniform Act, no state actually enacted this legislation.

22. *See, e.g.*, Holloway v. Bristol-Myers Corp., 485 F.2d 986 (D.C. Cir. 1973) (holding that Congress did not authorize a private right of action in connection with passage of the FTC Act, the legislation which created the Commission).

23. 1978 Statement of Basis and Purpose 43 Fed. Reg. 59,614, 59,723.

24. *See, e.g.*, Freedman v. Meldy's, Inc., 587 F. Supp 658, 661–62 (E.D. Pa. 1984).

25. *See* Berry et al., *supra* note 8, at 820.

26. Uniform Franchise & Bus. Opportunities Act (1987), Bus. Franchise Guide (CCH) ¶ 3600.

27. *See* Berry et al., *supra* note 8 at 822–24.

28. *See id.*

29. *See* Model Franchise Inv. Act (1990), Bus. Franchise Guide (CCH) ¶ 3700.

These previous attempts at uniform state franchise regulation were seemingly doomed by their failure to demonstrate to states that there was widespread support for their goals. Support for requiring pre-sale franchise disclosures could be, and has been, demonstrated,[30] but there was no consensus for either eliminating existing registration requirements in states that had them, or imposing universal registration requirements in states that did not. The Model Act's drafters likely failed in their endeavor because they created obstacles—namely, the requirement that states allocate resources to a new franchise bureaucracy without any broad consensus for this among constituents.

It is worth considering what a private right of action to enforce the FTC Rule would have looked like, and how a prototypical state franchise law might provide franchisees with similar protections, without additionally requiring states to allocate resources to creating a new state agency.

V. The Current Proposed Uniform Franchise Disclosure Act

The Act, attached at Appendix A, is intended to provide a private right of action for violation of pre-sale disclosure obligations in states where no such right currently exists. It would not (1) eliminate registration requirements in any state where they currently exist; (2) require any state to hire personnel, establish a new state agency or authorize any expenditures; or (3) require franchisors to make changes to their existing documents or procedures to comply with the Act. The Act incorporates existing requirements of the FTC Rule, while creating a private right of action for FTC Rule violations. In this way, the Act provides the private right of action that the FTC intended, as expressed in its original Statement of Basis and Purpose.[31] The most pertinent provisions of the Act are discussed below.

- Section 100.6(A) of the Act provides what the FTC has always intended: private enforcement for violations of the FTC Rule.[32] If the franchisor commits a material violation, the private right of action allows the franchisee to rescind a transaction, recover his damages (or $25,000, if greater), or institute a class action.[33] Attorney fees may be awarded to a successful franchisee, or to the franchisor where a franchisee is found to bring a claim in bad faith.[34] Additional remedies are available to the state attorney general, including injunctive relief.[35]
- The Act's definitions are taken almost verbatim from the FTC Rule, with only minor exceptions. For example, a definition has been added for "located in this state" to clarify that the disclosure obligation does

30. *See supra* Part I.
31. *See* 1978 Statement of Basis and Purpose, 43 Fed. Reg. 59,614, 59,723.
32. *See* App. A, § 100.6(A).
33. *See id.* § 100.6.
34. *See id.* § 100.6(B).
35. *See id.* § 100.5.

not relate to franchisees located outside the state, regardless of which state's law is selected in the franchise agreement.[36]

- The Act incorporates all of the existing exemptions in the FTC Rule, insuring that a franchisor choosing not to make disclosures in reliance on an FTC Rule exemption will likewise be exempt under the Act.[37]
- The basic disclosure obligations of the FTC Rule are incorporated into the Act without change, along with the specific FTC Rule requirements for content of the disclosure document.[38]
- Various additional prohibitions are included (Section 100.4) and parrot the FTC Rule's "Additional prohibitions" in 16 C.F.R. § 436.9.[39]
- The General Provisions section includes several additional items.[40] These include a four-year statute of limitations on claims,[41] a provision making controlling shareholders or members jointly liable for violations,[42] and a requirement that any mediation, arbitration, or litigation be subject to the law of the franchisee's state, and be conducted in the franchisee's state, if the dispute involves a claim under the Act.[43]

36. *See id.* § 100.1(n).
37. *See id.* § 100.2.
38. *See id.* §§ 100.2, 100.3.
39. *See id.* § 100.4.
40. *See generally id.* § 100.7.
41. *See id.* § 100.7(A).
42. *See id.* § 100.7(C). Joint liability of controlling owners of a franchisor entity is necessary to address instances of noncompliance involving new or insolvent businesses. Relaxed financial statement reporting requirements for new franchisors in the FTC Rule cause most first-time franchisors to organize new entities to act as the franchisor. These entities may be started with nothing more than a trademark license, shared use of common office space, and $500 in the bank. If the franchisor entity receives $100,000 in franchise fees, there is generally no legal barrier to its owners paying this amount to themselves as salaries, thereby rendering their entity effectively judgment-proof in any subsequent litigation.

An Ohio state court case illustrates why these provisions are necessary. *See* Jori, LLC v. B2B Int'l, LLC, 2018 WL 1571936 (Ohio Ct. App., Mar. 30, 2018) (recounting the procedural history prior to trial). In that case, the plaintiff purchased rights to operate a restaurant under a license agreement without receiving any disclosure document. *Id.* at *1. The transaction was later found to violate Ohio's Business Opportunity Act. *Id.* at *4. The seller was operating three other restaurants under the same mark, but the existing restaurants and the franchise business were each operated under separate corporate entities, and the licensor entity had only recently been created, with a $500 initial capitalization. The licensor entity had previously distributed the $20,000 initial franchise fee to its shareholder, leaving it essentially insolvent. The jury found for the plaintiff, granted plaintiff's request for rescission of the transaction, and entered a monetary award for the plaintiff, but decided that the circumstances did not satisfy Ohio's difficult test for piercing the corporate veil. In other words, the plaintiff won the battle but lost the war because it won a jury verdict, but was left with only an uncollectible judgment.

Franchisees should not be required to rely on common-law rules for piercing the veil in such cases, since recovery under that theory is notoriously difficult and unpredictable. Owner liability is already imposed under some state franchise laws, and the concept of joint liability does not increase the franchisor's liability in such cases; it only prevents a franchisor from organizing a new entity to conduct the franchising business as a shield to its own liability.

43. *See* Appendix A § 100.7(F). This provision would not invalidate dispute resolution provisions requiring prior mediation, or arbitration, but would simply dictate the forum for these procedures. In the past, franchisors have sometimes used their dispute resolution and forum-selection clauses to prevent or deter franchisees from bringing claims. *See, e.g.*, Nagrampa v.

VI. Conclusion

Since the FTC Rule was passed in 1979, the concept of pre-sale franchise disclosures has formed the cornerstone of franchise law practice. However, there is no private right of action for violation of the FTC Rule, and a majority of states still do not have any laws requiring franchise sellers to provide a disclosure document to residents of their state who purchase a franchise. Franchisors thus have no accountability in those states because franchisees have no cause of action if a franchisor provides a defective disclosure document, otherwise violates disclosure rules, or fails to give them any disclosure document at all.

This article provides the text of an Act to require pre-sale franchise disclosures. Passage of the Act would not require any state to create a new state agency or allocate budgetary resources to franchise law enforcement, but would give injured franchisees the tools needed to protect themselves against noncomplying franchisors. Franchisees in at least thirty-two states currently lack such protections, and it is hoped that some or all of these states will adopt the proposed Act.

Thirty years ago, the franchise bar's esteemed recently departed colleague, Rupert Barkoff, wrote an article describing his efforts to enact the Uniform Act.[44] His closing comments in that article resonate as strongly today as they did then:

> At the 1982 Forum meeting in Williamsburg, I suggested to those present that we, as franchise lawyers, should lessen the emphasis on where the law is and instead focus on where the law should be. . . . [This] presents us with the opportunity to shape the future of our field in a constructive, positive manner. We must not let this opportunity pass us by.

Mailcoups, Inc., 469 F.3d 1257 (9th Cir. 2006) (holding contract provision unconscionable where it required a California direct mail advertising franchisee to arbitrate her dispute in Massachusetts); Zounds Hearing Franchising, LLC v. Bower, 2017 WL 4399487, at *12 (D. Ariz. Sept. 19, 2017) (holding that Ohio's Business Opportunity statute invalidated contract clauses selecting an out-of-state forum or application of another state's law, where the claim was based on violation of the statute).

While there are legitimate business reasons for franchisors to prefer to conduct litigation only in their home states, franchisors are generally better able than franchisees to bear the cost of contesting litigation in distant locations. Franchisors in such circumstances have previously made an affirmative choice to sell their franchises in the franchisee's state, while the franchisee operating a franchise in its home state has made no such choice regarding the franchisor's state. Furthermore, laws in several states already require litigation to be contested under the law of their states, or at a forum within their state. *See, e.g.*, Ill. Comp. Stat. § 705/1 *et seq.*; Ind. Code § 23-2-2.5-1 *et seq.*; Md. Code Ann. Bus. Reg. § 14-201 *et seq.*; Mich. Comp. Laws § 445.1501 *et seq.*; Minn. Stat. § 80c.01 *et seq.*; N.D. Cent. Code § 51-19-01 *et seq.*; Ohio Rev. Code §1334.15; R.I. Gen. Laws § 19-28.1-1 *et seq.*; Wash. Rev. Code § 19.100.010 *et seq.* These requirements can be effected through provisions in the laws, requirements for state-specific contract amendments, or both.

44. Rupert Barkoff, *Walking the Uniform Franchise and Business Opportunities Act to and Through the State Legislatures*, 7 Franchise L.J. 7 (1988).

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Appendix A

An Act for the Regulation of Franchise Disclosures

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF _______________:

Section 1. As used in sections ____________ of the [laws of __________],

CHAPTER 100: Franchise Disclosure Obligations

Subpart A—Definitions

§ 100.1 Definitions.

Unless stated otherwise, the following definitions apply throughout Chapter 100 (“this Act”):

(a) *Action* includes complaints, cross claims, counterclaims, and third-party complaints in a judicial action or proceeding, and their equivalents in an administrative action or arbitration.

(b) *Affiliate* means an entity controlled by, controlling, or under common control with, another entity.

(c) *Confidentiality clause* means any contract, order, or settlement provision that directly or indirectly restricts a current or former franchisee from discussing his or her personal experience as a franchisee in the franchisor’s system with any prospective franchisee. It does not include clauses that protect franchisor’s trademarks or other proprietary information.

(d) *Disclose*, *state*, *describe*, and *list* each mean to present all material facts accurately, clearly, concisely, and legibly in plain English.

(e) *Financial performance representation* means any representation, including any oral, written, or visual representation, to a prospective franchisee, including a representation in the general media, that states—expressly or by implication—a specific level or range of actual or potential sales, income, gross profits, or net profits. The term includes a chart, table, or mathematical calculation that shows possible results based on a combination of variables.

(f) *Fiscal year* refers to the franchisor’s fiscal year.

(g) *Fractional franchise* means a franchise relationship that satisfies the following criteria when the relationship is created:

(1) The franchisee, any of the franchisee's current directors or officers, or any current directors or officers of a parent or affiliate, has more than two years of experience in the same type of business; and

(2) The parties have a reasonable basis to anticipate that the sales arising from the relationship will not exceed 20% of the franchisee's total dollar volume in sales during the first year of operation.

(h) *Franchise* means any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:

(1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark;

(2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation; and

(3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.

(i) *Franchisee* means any person who is granted a franchise.

(j) *Franchise seller* means a person that offers for sale, sells, or arranges for the sale of a franchise. It includes the franchisor and the franchisor's employees, representatives, agents, subfranchisors, and third-party brokers who are involved in franchise sales activities. It does not include existing franchisees who sell only their own outlet and who are otherwise not engaged in franchise sales on behalf of the franchisor.

(k) *Franchisor* means any person who grants a franchise and participates in the franchise relationship. Unless otherwise stated, it includes subfranchisors. For purposes of this definition, a "subfranchisor" means a person who functions as a franchisor by engaging in both pre-sale activities and post-sale performance.

(l) *FTC Rule* means the body of regulations promulgated by the United States Federal Trade Commission for the regulation of pre-sale franchise disclosures and published at 16 C.F.R. § 436, as may be amended from time.

(m) *Leased department* means an arrangement whereby a retailer licenses or otherwise permits a seller to conduct business from the retailer's location where the seller purchases no goods, services, or commodities directly or indirectly from the retailer, a person with whom the retailer requires the

seller to do business, or a retailer-affiliate if the retailer advises the seller to do business with the affiliate.

(n) *Located in this state* means that a business is operated primarily from a fixed location in this state, or operated from a mobile location or vehicle, where the mobile location or vehicle is intended to operate in this state to a greater extent than in any other state. If the business operates primarily over the Internet, or through other means not requiring use of any specific physical location, the business shall be deemed located in this state if one or more individuals who control the business have their primary residence in this state.

(o) *Parent* means an entity that controls another entity directly, or indirectly through one or more subsidiaries.

(p) *Person* means any individual, group, association, limited or general partnership, corporation, or any other entity.

(q) *Plain English* means the organization of information and language usage understandable by a person unfamiliar with the franchise business. It incorporates short sentences; definite, concrete, everyday language; active voice; and tabular presentation of information, where possible. It avoids legal jargon, highly technical business terms, and multiple negatives.

(r) *Predecessor* means a person from whom the franchisor acquired, directly or indirectly, the major portion of the franchisor's assets.

(s) *Principal business address* means the street address of a person's home office in the United States. A principal business address cannot be a post office box or private mail drop.

(t) *Prospective franchisee* means any person (including any agent, representative, or employee) who approaches or is approached by a franchise seller to discuss the possible establishment of a franchise relationship.

(u) *Required payment* means all consideration that the franchisee must pay to the franchisor or an affiliate, either by contract or by practical necessity, as a condition of obtaining or commencing operation of the franchise. A required payment does not include payments for the purchase of reasonable amounts of inventory at bona fide wholesale prices for resale or lease.

(v) *Sale of a franchise* includes an agreement whereby a person obtains a franchise from a franchise seller for value by purchase, license, or otherwise. It does not include extending or renewing an existing franchise agreement where there has been no interruption in the franchisee's operation of the business, unless the new agreement contains terms and conditions that differ materially from the original agreement. It also does not include the transfer of a franchise by an existing franchisee where the franchisor has had no significant involvement with the prospective

transferee. A franchisor's approval or disapproval of a transfer alone is not deemed to be significant involvement.

(w) *Signature* means a person's affirmative step to authenticate his or her identity. It includes a person's handwritten signature, as well as a person's use of security codes, passwords, electronic signatures, and similar devices to authenticate his or her identity.

(x) *Trademark* includes trademarks, service marks, names, logos, and other commercial symbols.

(y) *Written* or *in writing* means any document or information in printed form or in any form capable of being preserved in tangible form and read. It includes typeset, word-processed, or handwritten documents; information on computer disk or CD-ROM; information sent via email; or information posted on the Internet. It does not include mere oral statements.

Subpart B—Franchisors' Obligations

§ 100.2 Obligation to furnish documents.

In connection with the offer or sale of a franchise to be located in this state, unless the transaction is exempted under § 436.8 of the FTC Rule, or the transaction concerns [activities separately regulated by motor vehicle, liquor, gas station, or other dealer legislation], it is a violation of this Act:

(a) For any franchisor to fail to furnish a prospective franchisee with a copy of the franchisor's current disclosure document, as described in the FTC Rule, at least fourteen calendar days before the prospective franchisee signs a binding agreement with, or makes any payment to, the franchisor or an affiliate in connection with the proposed franchise sale.

(b) For any franchisor to alter unilaterally and materially the terms and conditions of the basic franchise agreement or any related agreements attached to the disclosure document without furnishing the prospective franchisee with a copy of each revised agreement at least seven calendar-days before the prospective franchisee signs the revised agreement. Changes to an agreement that arise out of negotiations initiated by the prospective franchisee do not trigger this seven calendar-day period.

(c) For purposes of paragraphs (a) and (b) of this section, the franchisor has furnished the documents by the required date if:

(1) A copy of the document was hand-delivered, faxed, emailed, or otherwise delivered to the prospective franchisee by the required date;

(2) Directions for accessing the document on the Internet were provided to the prospective franchisee by the required date; or

(3) A paper or tangible electronic copy (for example, computer disk or CD- ROM) was sent to the address specified by the prospective franchisee by first-class United States mail at least three calendar days before the required date.

Subpart C—Contents of a Disclosure Document

§ 100.3 Content of a Disclosure Document.

The Disclosure Document required by this Act shall conform to the requirements specified for preparation and updating of disclosures in §§ 436.3–436.5 of the FTC Rule, as further explained by the instructions contained in §§ 436.6 and 436.7 of the FTC Rule, and the various Appendices included in the FTC Rule.

Subpart D—Additional Prohibitions

§ 100.4 Additional prohibitions.

It shall be unlawful for any franchise seller covered by this Act to:

(a) Make any claim or representation, orally, visually, or in writing, that contradicts the information required to be disclosed by this part.

(b) Misrepresent that any person:

(1) Purchased a franchise from the franchisor or operated a franchise of the type offered by the franchisor.

(2) Can provide an independent and reliable report about the franchise or the experiences of any current or former franchisees.

(c) Disseminate any financial performance representations to prospective franchisees unless the franchisor has a reasonable basis and written substantiation for the representation at the time the representation is made, and the representation is included in the franchisor's disclosure document. In conjunction with any such financial performance representation, the franchise seller shall also:

(1) Disclose the information required by §§ 436.5 of the FTC Rule if the representation relates to the past performance of the franchisor's outlets.

(2) Include a clear and conspicuous admonition that a new franchisee's individual financial results may differ from the result stated in the financial performance representation.

(d) Fail to make available to prospective franchisees upon reasonable request, written substantiation for any financial performance representations made in the franchisor's disclosure document.

(e) Fail to furnish a copy of the franchisor's disclosure document to a prospective franchisee earlier in the sales process than required under the FTC Rule, upon reasonable request.

(f) Fail to furnish a copy of the franchisor's most recent disclosure document and any quarterly updates to a prospective franchisee, upon reasonable request, before the prospective franchisee signs a franchise agreement.

(g) Present for signing a franchise agreement in which the terms and conditions differ materially from those presented as an attachment to the disclosure document, unless the franchise seller informed the prospective franchisee of the differences at least seven days before execution of the franchise agreement.

(h) Disclaim or require a prospective franchisee to waive reliance on any representation made in the disclosure document or in its exhibits or amendments. Provided, however, that this provision is not intended to prevent a prospective franchisee from voluntarily waiving specific contract terms and conditions set forth in his or her disclosure document during the course of franchise sale negotiations.

(i) Fail to return any funds or deposits in accordance with any conditions disclosed in the franchisor's disclosure document, franchise agreement, or any related document.

Subpart E—Enforcement by the State

§ 100.5 Actions by the Attorney General Authorized.

A. If the Attorney General has reasonable cause to believe that a person has engaged in an act or practice that violates this Act, he or she may bring any of the following actions:
   a. An action to obtain a declaratory judgment that the act or practices violates provisions of this Act;
   b. An action to obtain a temporary restraining order, preliminary injunction, or permanent injunction to restrain the act or practice. On motion of the attorney general, or on its own motion, the court may impose a civil penalty of not more than twenty thousand dollars for each violation of a temporary restraining order, preliminary injunction or permanent injunction issued under this section.
   c. A class action on behalf of franchisees damaged by a violation of this Act.

B. On motion of the attorney general and without bond, in an attorney general's action under this section, the court may make appropriate

orders, including appointment of a referee or a receiver, for sequestration of assets, to reimburse franchisees found to have been damaged, to carry out a transaction in accordance with the franchisee's reasonable expectations, to strike or limit the applicability of unconscionable clauses of agreements so as to avoid an unconscionable result or to grant other appropriate relief.

C. In addition to the other remedies provided in this section, the attorney general may request, and the court may impose, a civil penalty of not more than twenty thousand dollars for each violation found by the court.

Subpart F—Enforcement by a Franchisee

§ 100.6 Remedies.

A. For a material violation of this Act, a franchisee has a cause of action and may seek any or all of the following:
   a. To rescind the transaction and recover all sums paid to the franchise seller, less the fair market value at the time of delivery of any goods supplied by the franchise seller that are not returned by the franchisee;
   b. To recover the amount of the franchisee's damages, or twenty-five thousand dollars, whichever is greater;
   c. To recover damages or other appropriate relief in a class action under Civil Rule 23.

B. The court may award the prevailing party a reasonable attorney fee, if either of the following apply:
   a. The franchisee alleging violations of this Act has brought an action that is groundless or brought in bad faith;
   b. The franchise seller committed an act or practice found to constitute a material violation of this Act.

Subpart G—General Provisions

§ 100.7 General Provisions.

A. The courts of common pleas and municipal courts within their respective monetary jurisdiction, have jurisdiction over claims brought with respect to Acts or practices governed by this Act.

B. No action under this Act may be brought after the earlier of
   (i) four years from the date of the act or practice claimed to violate this Act, or
   (ii) four years from the date on which the franchisee and franchise seller executed the related agreement.

C. For purposes of this Act, a person who directly or indirectly controls a person (including a corporation, LLC or similar entity) who violates this Act is also jointly and severally liable with and to the same extent as the controlled person.

D. In any case alleging that a transaction is exempt under §100.2 of this Act, the person claiming entitlement to the exemption has the burden of proof as to the application of the exemption.

E. The legislature declares that it is the intent of this Act to protect purchasers of franchises by requiring that sellers provide them with the necessary disclosures to permit them to make an intelligent investment decision. The legislature further declares that the provisions of this Act represent a fundamental public policy of this state.

F. Any provision of an agreement between a franchisee and a franchise seller that

   (i) requires that claims be mediated, arbitrated or adjudicated at a location outside this state, or

   (ii) specifies application of the laws of a different state, is void and unenforceable as it relates to claims asserted under this Act.

G. Any waiver or attempted waiver by a franchisee of the provisions of this Act is void and unenforceable.