



Franchise Academy

The Franchise Disclosure Document ***What can you learn from the Franchisor's FDD?***

History of the FDD

Prior to the 1970s and the proven success of McDonalds, there was little franchising momentum in the U.S. mostly caused by unscrupulous people who ran scams under the guise of a Franchise operation and gave franchising a bad name. And, because of the abuse back then, the franchise industry sometimes still suffers that poor perception today. However, upon investigation, one quickly realizes that great franchise companies are anything but unscrupulous.

In 1979 the Federal Trade Commission (FTC) stepped in to halt the crimes and installed what is known as the FTC Rule. This rule requires that all franchisors submit to all potential franchisees a document called the Franchise Disclosure Document (FDD). The purpose of the FTC Rule (manifested in the FDD) was to provide enough information and transparency so the prospective franchisee could make an informed decision about purchasing that franchise.

The FDD serves as a protection for the individual against making a decision based on information not supported by fact. The FTC Rule requires franchisors provide the FDD to the prospective franchisee at the earlier of the first personal meeting or 10 business days before the franchisee signs an agreement or pays any money. The recipient is required to sign a receipt of the FDD. A franchisor's FDD must be updated on an annual basis, or sooner if certain conditions are met.

The FDD contains 23 items that describe the Franchisor, The Franchise Program and the Franchise Agreement. Here is a brief description of the items a FDD must contain:

Who am I dealing with?

- Item 1 – The Franchisor, Parents, Predecessors & Affiliates
- Item 2 – Business Experience
- Item 3 – Litigation – Covers the past 10 years
- Item 4 – Bankruptcy
- Item 20 – Outlets and Franchise Information

The franchisor must provide you with a history of their past activities, especially as it may relate to potentially negative information. This information must be provided not only for the company itself but also for the officers and directors.

The information includes factors like the business experience of the company and its principles and recent litigation or bankruptcy history for either.

What is the cost?

- Item 5 – Initial Fees
- Item 6 – Other Fees
- Item 7 – Initial Investment

The relevant financial terms of the franchise opportunity must be clearly defined. This would include the initial franchise fees, other startup costs, and an investment range estimate for your total cost to get into the business. The FDD must also disclose any other fees, such as the royalty, marketing and renewal fees that the franchisee will have to pay throughout the life of their franchise.

What Do I Get?

- Item 8 – Supply Sources
- Item 11 – Assistance, Training, etc.
- Item 12 – Territory
- Item 13 – Trademarks
- Item 14 – Copyrights/Confidential Info
- Item 17 – Renewal, termination, Transfer & Dispute Resolution

The company must also disclose relevant information on a number of other factors such as financing programs, territory, trademarks and patents, renewal or transfer provisions and public figures.

What Must I Do?

- Item 8 – Sourcing Restrictions
- Item 9 – Franchisee Obligations
- Item 15 – Participation in the business

The company must disclose the obligations of both you and the company under the terms of the franchise agreement. They must also spell out any mandated restrictions that you will operate under in terms of your purchasing options and behavior as a franchisee.

What Can I Make?

- Item 19 – Financial Performance Representations

The FTC rules leave it up to the franchisor whether they want to supply information about the earnings that can be achieved in their business. If a franchisor does want to provide earnings claims, they must follow stringent rules on how this information can be given to a prospective franchisee. It is essential for the franchisor to make sure that the data provided is as accurate and representative as possible and they must also clearly label any assumptions or qualifications on the data provided. As a result, earnings claims can take a variety of angles and approaches, so reviewing the background information is vital. **The franchise company is NOT permitted to give financial earnings information above and beyond what is stated in the FDD.**

- Exhibits. The company must also provide other data including audited financial statements, current franchisee lists with contact information, contracts and receipts.

Individual State Requirements

In addition to the laws that mandate disclosure, there are also some states that have passed specific laws to further protect franchisees in that state. These laws may add additional disclosures or rules about franchise agreement terms. As an example of this, there are a number of states that require that the legal venue for any dispute must be in their state rather than in the state where the franchise company is located. These types of additional requirements vary from state to state but any that are appropriate to your situation in your state should be disclosed in the FDD you receive.

The following “filing states” currently have additional requirements above and beyond the requirements of the FTC:



California	New York
Hawaii	North Dakota
Illinois	Rhode Island
Indiana	South Dakota
Maryland	Virginia
Michigan	Washington
Minnesota	Wisconsin

Your responsibility

The most important point to remember regarding the FDD is that you need to read and understand the material that the franchisor is disclosing to you. The FTC has a requirement that these documents must be presented in understandable English so that the material should be clear. It won't make any difference, however, if you don't carefully review the material.

Make sure you take the time to study the information supplied to you and you'll have a much better chance of making sure that these legal requirements actually serve their purpose of protecting or safeguarding your interests, both before and after you purchase a Franchise.