

Franchise Disclosure Document

A **Franchise Disclosure Document** (FDD) is a legal document which is presented to prospective buyers of franchises in the pre-sale disclosure process in the United States.

Under the Franchise Rule, which is enforced by the Federal Trade Commission (FTC), a prospective franchisee must receive the franchisor's FDD franchise disclosure document at least 14 days before they are asked to sign any contract or pay any money to the franchisor or an affiliate of the franchisor. The prospective franchisee has the right to ask for (and get) a copy of the sample franchise disclosure document once the franchisor has received the prospective franchisee's application and agreed to consider it. The franchisor may provide a copy of its franchise disclosure documents on paper, via email, through a web page, or on a disc.

All franchise buyers should use information contained in the FDD as part of their franchise research.

Franchise Disclosure Document Requirements

The document discloses extensive information about the franchisor and the franchise organization which is intended to give the potential franchisee enough information to make educated decisions about their investments. The information is divided into a cover page, table of contents and 23 categories called "Items"

Twenty one of the items contain information primarily pertaining to the franchisor but, unfortunately, only two of the items contain information pertaining to the performance of the franchise, itself, that is being offered for sale. One of these items, Item 19, "Earnings Claims" is an optional disclosure under the FTC Rule and State.

The other, Item 20, provides a current accounting of the number of units that comprise the systems and reports the terminations and sale-transfers which have been applied to report the total number of units that comprise the system. Item 20 also provides the names and contact information of franchisees, current and ex-franchisees, who may be contacted for information in the due diligence process to be conducted by prospective buyers of the franchises offered for sale.

1. The Franchisor and Any Parents, Predecessors, and Affiliates

This section tells how long the franchisor has been in business, likely competition, and any special laws that pertain to the industry, like any license or permit requirements. This will help the prospective franchisee understand the costs and risks they are likely to take on if they purchase and operate the franchise.

2. Identity and Business Experience of Key Persons

This section identifies the executives of the franchise system and describes their experience.

3. Litigation History

This section discusses prior litigation—whether the franchisor or any of its executive officers have been convicted of felonies involving fraud, violations of franchise law, or unfair or deceptive practices law, or are subject to any state or federal injunctions involving similar misconduct. It also says whether the franchisor or any of its executives have been held liable for—or settled civil actions involving—the franchise relationship. A number of claims against the franchisor may indicate that it has not performed according to its agreements, or, at the very least, that franchisees have been dissatisfied with its performance.

This section also should say whether the franchisor has sued any of its franchisees during the last year, a disclosure that may indicate common types of problems in the franchise system. For example, a franchisor may sue franchisees for failing to pay royalties, which could indicate that franchisees are unsuccessful, and therefore, unable or unwilling to make their royalty payments.

4. Bankruptcy

This section discloses whether the franchisor or any of its executives have been involved in a recent bankruptcy, information that can help potential franchisees assess the franchisor's financial stability and whether the company is capable of delivering the support services it promises.

5. Initial Franchise Fee

This section describes the costs involved in starting and operating a franchise, including deposits or franchise fees that may be non-refundable, and costs for initial inventory, signs, equipment, leases, or rentals. It also explains ongoing costs, like royalties and advertising fees.

6. Other Fees and Expenses

Training

This section explains the franchisor's training and assistance program.

Advertising

This section has information on advertising costs. Franchisees often are required to contribute a percentage of their income to an advertising fund.

7. Franchisee's Estimated Initial Investment

8. Restrictions on Sources of Products and Services

This section tells whether the franchisor limits suppliers from whom a franchisee may purchase goods.

9. Obligations of the Franchisee

10. Financing Arrangements

11. Obligations of the Franchisor

12. Territory

13. Trademarks

14. Patents, Copyrights, and Proprietary Information

15. Obligation of the Franchisee to Participate in the Actual Operation of the Franchise Business

16. Restrictions on Goods and Services Offered by the Franchisee

17. Renewal, Termination, Repurchase, Modification and/or Transfer of the Franchise Agreement, and Dispute Resolution

This section spells out the conditions under which the franchisor may end a franchisee's franchise and a franchisee's obligations to the franchisor after termination. It also defines the conditions under which a franchisee can renew, sell, or assign the franchise to others.

18. Public Figures

19. Financial Performance Representations

Franchisors are not required to disclose information about potential income or sales, but if they do, the law requires that they have a reasonable basis for their claims and that they make the substantiation for their claims.

Sample Size

The disclosure document should tell the sample size and the number and percentage of franchisees who reported earnings at the level claimed.

Average Incomes

Gross Sales

Net Profits

Franchisors often do not have data on net profits of their franchisees.

Geographic Relevance

Earnings may vary with geography. The disclosure document should note geographic or other differences among the group of franchisees whose earnings are reported and a franchisee's likely location.

Franchisees' Backgrounds

Reliance on Earnings Claims

20. List of Franchise Outlets

This section has very important information about current and former franchisees.

If a franchisee buys an existing outlet that was reacquired by the franchisor, the franchisor must tell the franchisee who owned and operated the outlet for the last five years.

21. Financial Statements

The disclosure document gives important information about the company's financial status, including audited financial statements. A franchisee can find explanatory information about the franchisor's financial status in notes to the financial statements.

22. Contracts

23. Acknowledgment of Receipt

"In Franchising you are in business for yourself but not by yourself"