

## **WHAT IS A FRANCHISE DISCLOSURE DOCUMENT ?**

The Franchise Disclosure Document (“FDD”) (which was formerly known as the Uniform Franchise Offering Circular) is a disclosure document mandated by the Federal Trade Commission (“FTC”). Franchisors are required to present this document to potential franchisees at least 14 days before they sign any binding franchise agreement. The document consists of 23 specific items of information including the history of the franchise being offered, biographies of the officers and directors of the franchisor, costs to the franchisee, obligations of the franchisor and franchisee, a list of current franchisees, and much more. The FDD is not a binding agreement - it is merely intended to provide the franchisee with enough information to make an informed decision.

Attached to the FDD will be several exhibits. A couple of these exhibits are required disclosures by the FTC, but the others (see items 1-7 below) are the actual agreements that will govern your relationship with the franchisee. The exact exhibits will be specific to the particular franchise. Listed below are some of the more common exhibits and what they are intended to do.

1. Franchise Agreement. This is the primary document that will govern your relationship with the franchisee. It will include all applicable fees as well as the rights and obligations of both the franchisee and franchisor.
2. Confidentiality/Non-Compete Agreement. During the term of the Franchise Agreement you will want to restrict the franchisee from involvement in any competitive businesses, regardless of where such competitive businesses are located. After the Franchise Agreement terminates or expires, you will want to prohibit the franchisee for a certain period (2 years is typical) from involvement in any competitive business within a certain radius of any of your franchised locations. The distance depends on the type of franchise.
3. Area Developer Agreement. This is an agreement whereby you grant a franchisee the right to open a specific number of locations within a defined area in a defined period of time. Typically, the franchisees will agree to pay a certain fee upfront, which will be credited back to them when they open each of the required franchise locations. If the required locations are not opened by the time deadline, the up-front fee is forfeited to the franchisor.
4. Personal Guarantee. This is a document that specifies that the franchisee will be personally liable to the franchisor for all obligations owed to the franchisor, regardless of whether the franchisee has formed a corporate entity to purchase the franchise.
5. Equipment or Inventory Contract. You may want to require your franchisee to purchase certain equipment, supplies or inventory directly from you. This is an excellent way of creating multiple revenue streams from each franchisee.
6. Collateral Assignment of Lease. This document essentially allows the franchisor to step into the shoes of the franchisee and take over the lease with the landlord if the franchisee is in breach. It is designed to prevent the loss of franchised locations due to the actions of the franchisee. Generally, the franchisee is required to get the landlord to sign this exhibit.
7. State Law Addenda. If you are offering your franchise in a state which has its own franchise laws ([for a discussion of state laws click here](#)) you may be required to include

an addendum to the franchise agreement which applies certain special terms to the members of that state.

8. Operating Manual Table of Contents. Along with the Franchise Agreement, the Operating Manual is the document that will govern your day-to-day operations and interactions with the franchisee. While the franchise agreement speaks in broad terms, the Operating Manual sets forth the more specific day to day operating procedures for all franchisees. You will want to include items such as: required business hours for franchisee's store, opening and closing procedures, hiring standards and the like. Due to its confidential nature, you should not allow the franchisee to review the Operating Manual until after they have signed a franchise agreement. This exhibit is merely intended to inform the franchisee of the types of matters the Operating Manual will cover.
9. Financial Statements. As a franchisor, you will be required to include the following audited financial statements as an exhibit to the FDD: (i) balance sheets as of the end of the last 2 fiscal years, (ii) statements of operations for the last 3 fiscal years, (iii) statements of stockholders' equity for the last 3 fiscal years, and (iv) cash flow statements for the last 3 fiscal years. If the most recent balance sheet and statement of operations are more than 90 days old, more current, unaudited financial statements for the interim period must also be provided. For new franchisors, I generally establish a new entity that can greatly simplify these requirements and therefore reduce your expenses.
10. List of State Agencies. Approximately half of the states have franchise laws which supplement the federal rules. The franchisor is required to list the state agencies and agents for service of process if the franchisor plans to operate franchises in any of these states.

Timely provision of the FDD to potential franchisees will satisfy your disclosure requirements under Federal Law. However, you need to be aware that about half the states have their own laws regarding franchises.