As you may all be aware, we have recently completed the nomination process for election to the Forum’s Governing Committee, for terms beginning in August 2018. I am frequently asked by Forum members about the pathway to leadership within the Forum and to membership on the Governing Committee. First and foremost, the pathway to leadership is paved with hard work and consistent participation in the life of the Forum. This can take many forms, including attending the Annual Meeting and participating on the steering committees of one of the Forum’s many committees, divisions and caucuses. Because Governing Committee members are required to speak during two years of their three year term, Forum members must demonstrate writing skills necessary to produce a substantive paper that will qualify for continuing legal education credit by authoring or co-authoring an article for the Franchise Lawyer, the Franchise Law Journal or other Forum publication in order to be a serious candidate for election.

Members must also demonstrate a capacity for public speaking in a workshop setting. In addition, to ensure that no one firm or company dominates the Forum, we limit each firm and company’s participation to one member of the Governing Committee and one member of Senior Leadership (i.e., a division director [LADR, International, and Corporate Counsel], editor in chief of the Franchise Lawyer or of the Franchise Law Journal). The Nominating Committee also considers many types of diversity, including gender, racial, ethnic, sexual orientation and geographic. We also attempt to form a Governing Committee with members who represent franchisors and franchisees, members from large law firms and solo practitioners, as well as in-house counsel. The Nominating Committee endeavors to present the best slate it can to the Forum’s membership based on the consistent number of highly qualified candidates presented to it for nomination. This year’s Nominating Committee has nominated candidates for the four Member-at-Large positions on the Governing Committee, all beginning August 2018. The nominated candidates for the four...
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On May 8, 2017, the membership of the North American Securities Administrators Association ("NASAA") voted to adopt the NASAA Franchise Commentary on Financial Performance Representations at the 2017 NASAA Spring Conference in Washington, DC.

The Commentary is the product of over three years of work by the NASAA Franchise Project Group and went through two public comment periods. The purpose of the Commentary is to bring clarity to a number of questions posed by franchise regulators and franchisor and franchisee representatives about what is and is not permissible disclosure concerning financial performance representations.

The Federal Trade Commission’s Rule on Disclosure Requirements and Prohibitions Concerning Franchising ("FTC Rule") defines a financial performance representation to mean “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.” Disclosure of financial performance representations is permitted in accordance with the requirements of the FTC Rule, but is not required. The overarching mandate of the FTC Rule’s restrictions on financial performance representation disclosure is that the franchisor must have a reasonable basis for presenting the information.

The Commentary does not provide a specific definition for reasonable basis, but it does set forth guidance for making and substantiating a financial performance representation. Following are some of the specific substantive areas that the Commentary addresses.

Use of Company-Owned Outlet Data
A franchisor may base a financial performance representation on the gross sales from company-owned outlets alone only if the franchisor does not have any operational franchise outlets. An operational franchise outlet is one that has been in operation for at least a year (or a full season if the business is a seasonal one) as of the franchisor’s last fiscal year end. Otherwise, if there are operational franchise outlets, gross sales for those outlets must also be included in the disclosure. The policy behind this is simple. A franchisor should not be able to hide the performance of its franchisees if it is presenting this data since franchisee outlet data will likely be more relevant to the prospective franchisee.

If the financial performance representation includes net or gross profit disclosure, a franchisor may base its cost disclosure on the expenses incurred by its company-owned outlets. There are many legitimate reasons why a franchisor may want to do this. It may not have access to franchisee cost data. Reported franchisee cost data may be unreliable or reported in formats that are inconsistent. The Commentary provides that if the franchisor only includes costs from company-owned outlets, the financial performance representation must also disclose the following:

- Gross sales data from operational franchise outlets (if there are any);
- Actual costs incurred by company-owned outlets; and
- Supplemental data or adjustments to reflect actual and reasonably expected material financial and operational differences between operational franchise outlets and company-owned outlets.

The last item on the list – supplements and adjustments – may not be buried in a footnote or merely explained. These numbers must be disclosed in the same format as the rest of the data. If the...
The overarching mandate of the FTC Rule’s restrictions on financial performance representation disclosure is that the franchisor must have a reasonable basis for presenting the information.

presumption that the franchisees cannot be readily identified and the data may not be merged.

Use of Subsets
Subsets are generally permitted if three conditions are met: (1) the franchisor has a reasonable basis for presenting the information; (2) the financial performance representation is accurate; and (3) the disclosure is not misleading.

A subset based on data from the best performing outlets in the franchise system is not a permissible subset. The FTC has previously noted that this practice, also known as “cherry picking”, is likely to be misleading and have no reasonable basis. The Commentary confirms this, and goes on to require disclosure of the results of the corresponding subset of lowest performing outlets. Thus, if a franchisor includes disclosure for the top 50 franchisees, it must also include disclosure for the bottom 50 franchisees. What if, however, a franchisor designates a subset based on permissible criteria and coincidentally that subset also consists of the best performing outlets? For example, the franchisor institutes a voluntary supplemental training course and decides to disclose the gross sales of those franchisees who complete the course. That subset also equates to the highest performing outlets. In that case, a franchisor would be well advised to include a subset of the equivalent worst performing outlets in the financial performance representation.

The Commentary provides additional guidelines on subsets. A franchise system with a total of less than ten substantially similar outlets is too small to present subset information. That does not mean that the franchisor cannot include a financial performance representation in its disclosure. It only means that it must include disclosure based on all of the company-owned and operational franchise outlets.

If the subset a franchisor chooses is based on geographic criteria, the franchisor must disclose how and why that subset was selected. The franchisor can utilize geographic criteria if the information is not misleading. For example, an ice cream franchisor should not ordinarily base subset disclosure solely on the results of its franchisees in California and Florida.

Averages and Medians
The Commentary addresses the use of the statistical concepts of averages (or means) and medians. An average is the result of dividing the sum of a set of figures by the number of figures in the set. A median is the middle figure in the set.

If a financial performance representation includes an average, it must include the median as well. If the average presented is the amount of gross sales, the financial performance representation must also include the high and low figures in the set of numbers. Conversely, if the franchisor presents median numbers, it must include the average numbers along with them, and if median gross sales are disclosed, the franchisor must also include the high and low figures.

A franchisor may exclude from its calculation of the average or median, data from outlets that have closed during the time period measured. If it does exclude these outlets, the following additional information must be disclosed in the financial performance representation:
The number of company-owned outlets that closed (if the financial performance representation includes data from company-owned outlets);

- The number of franchise outlets that closed (if the financial performance representation includes data from franchise outlets); and

- The number of excluded outlets that closed after less than 12 months of operation.

If data is presented for multiple time periods, the same supplemental information must be included for each time period.

**Use of Forecasts and Projections**

Financial performance representations most often consist of historical numbers. Projections and forecasts are permitted, but many franchisors hesitate to use them. The Commentary makes clear that projections must be based on historical results rather than hypotheticals or expectations, and they must be based on the results of outlets substantially similar to those for which the franchise is offered.

Moreover, a projection or forecast must be based on the historical performance of substantially similar outlets from the same brand. The historical performance of other brands operated by the franchisor or of competitive brands operated by third parties or data from industry reports are specifically noted as impermissible bases.

**Disclaimers**

Other than the clear and conspicuous admonition that the FTC Rule requires a franchisor to include in every financial performance representation, no disclaimers are permitted. This was actually included in an earlier Commentary issued by NASAA, but the new Commentary expanded on this section. As a reminder, the following are the required admonitions:

For historical representations:

“Some [outlets] have [sold] [earned] this amount. Your individual results may differ. There is no assurance that you’ll [sell] [earn] as much.”

For projections:

“These figures are only estimates of what we think you may [sell] [earn]. Your individual results may differ. There is no assurance that you’ll [sell] [earn] as much.”

A franchisor may not vary the wording of the admonition unless the financial performance representation contains data other than gross sales, such as hotel occupancy rates. In those limited instances, the franchisor can adapt the language, but only to the extent necessary to reflect the difference in the data presented.

The Commentary also defines what “clear and conspicuous” disclosure means. It means that the admonition must be in a separate paragraph and must be in bold. It may not be in larger type than the rest of the disclosure. It must not be underlined or in capital letters.

Explanations of the information presented in the financial performance representations, such as the bases and assumptions for the information presented, are not disclaimers and may be included. What is not permitted are statements indicating that a franchisee should not rely on the information presented.

**When Does the Commentary Become Effective?**

A franchisor must be in compliance with the Commentary at the later of 180 days after its adoption or 120 days after a franchisor’s next fiscal year end, if the franchisor has an effective Franchise Disclosure Document as of the date of adoption. As noted above, NASAA adopted the Commentary on May 8, 2017. Therefore, for franchisors that did not have an effective Franchise Disclosure Document on that date, the deadline for compliance is November 4, 2017.

For franchisors that did have effective Franchise Disclosure Documents as of the date of adoption, the later date may be 120 days after the franchisor’s next fiscal year end. Therefore, for franchisors with a September 30 year end, the deadline is January 28, 2018. For franchisors with December 31 fiscal year ends, the deadline is April 30, 2018.

In conclusion, the Commentary is a welcome addition providing much needed guidance to franchisors and their counsel and to franchise regulators reviewing and commenting on Item 19 disclosures. For prospective franchisees, it will hopefully result in increased usefulness.
Join us this October as we celebrate the 40th Annual Forum on Franchise at the JW Marriott Resort & Spa in Palm Desert, CA.

You’ll discover ample opportunities to network, educational programs, and a glamorous “Old Hollywood” evening at Greta Garbo’s house.

Register today at americanbar.org/groups/franchising.html
Data Protection: Changes and Challenges for Franchisors Operating in the EU?

By James Mullock and Gabe Maldoff, Bird & Bird

Data is essential to any successful modern franchise system. Online sales, electronic and mobile marketing, and advances in analytics offer exciting opportunities for franchisors and franchisees. At their core, these technologies all rely on data.

But the use of data also presents risks for franchised businesses. Data breaches, cyber-attacks and privacy concerns can damage customer trust and tarnish brands. Franchises may be subject to regulatory action from authorities anywhere in the world that they collect data for breaches of those countries’ data privacy laws – and over 100 countries around the globe now have such laws.

To complicate matters further, the legal landscape is constantly changing, locked in a perpetual arms race with technological developments. In Europe, all eyes are fixed on May 25, 2018, when new legislation will introduce the world’s strictest privacy regime.

In Europe, all eyes are fixed on May 25, 2018, when new legislation will introduce the world’s strictest privacy regime.

For franchise systems, the challenges are especially great. Franchisors face the prospect of multi-million dollar fines due to their and/or their franchisees’ non-compliance. Moreover, uncertainty around international data transfers adds further complexity to global brands. The abolition and swift replacement of the Safe Harbor certification scheme with the Privacy Shield is not likely to be the end of the EU-US data transfer saga.

But regulatory change also presents opportunities. The GDPR will largely harmonize regulation across the European Union (“EU”), eliminating many country-specific requirements. With careful planning and early engagement with customer privacy, franchisors can mitigate data protection risks whilst reaping the benefits that digital business has to offer.

Understanding Data Protection: Personal Data

Personal data is any piece of information that reveals directly or indirectly an individual’s identity. Personal data may include names, email addresses, Social Security Numbers, zip codes or payment details as well as your marketing lists and any data you collect on employees and/or customers. The concept of personal data also encompasses less obvious identifiers, including IP addresses, location, stats about how often an individual engages with your services and even opinions.

Europe’s new regulation, the GDPR, will apply to virtually any entity, anywhere in the world, that processes the personal data of European residents, or monitors their behavior. Clearly, the scope of the GDPR is wide. It will even apply, for example, to a US-based franchisor that stores personal data about European customers or employees on a centralized platform on behalf of its franchisees.

Not only do data protection rules follow the data – so do the penalties. A franchisor located outside of the EU could find itself either jointly and severally liable or vicariously liable for the acts of its franchisees, depending on how the relationship is structured. Planning ahead in a few key areas can help mitigate the worst of these risks. To meet the 2018 deadline, planning must start now. Below we consider five areas to include in that process.

1. International Transfers of Personal Data

Perhaps one of the greatest data protection risks for US franchisors is the legality of transfers of personal data between their European and US operations.
European data protection law forbids the transfer of personal data outside the European Economic Area ("EEA"), except where the country of the recipient provides for adequate protection by law or the recipient puts in place specific compliance measures to protect the legal rights of European individuals.

Data is considered transferred even if only visible from outside the EEA – it need not be physically transported to be deemed transferred. Thus, for example, a franchisor’s remote access through a point of sale or business management system qualifies as a transfer.

Because the US is not considered to provide adequate legal protections, franchisors in the US must instead rely on contractual and other safeguards in order to have access to the data. But even these safeguards have risks. In 2015, the Court of Justice of the European Union struck down the Safe Harbor framework, which until that point had been the most important mechanism for US businesses that transferred data from the EU. In finding that US surveillance practices undermined the privacy rights of Europeans, the judgment called into question the adequacy of any transfers to the US and elsewhere, and has left organizations scrambling for alternative mechanisms to allow the legal transfer of personal data from the EU.

One option is to put in place Standard Contractual Clauses. These are complex contractual arrangements designed by the European Commission, which impose detailed requirements on parties that access the data, including in some cases, requiring pre-approval of vendors, audit rights and an obligation to notify the other party in the case of a breach.

Another option is certifying against the Privacy Shield, the successor to the previous Safe Harbor regime, which requires companies to self-certify and externally verify their compliance against seven privacy principles, on an annual basis.

The mechanism that an organization opts to use may affect its vendor contracts down the line, and the way in which obligations flow down its supply chain. For example, Privacy Shield requires certified organizations to have in place a data retention schedule and ensure that any data they hold is deleted after specific prescribed periods. This retention schedule obligation must be flowed down to any other organization that personal data is passed to – including technology vendors. Moreover, the organization must audit its own performance annually to ensure that its obligations are being met.

To add further complication, these alternative mechanisms are also vulnerable to the same legal scrutiny as the Safe Harbor regime. Indeed, European courts are already hearing challenges to these data transfer mechanisms. If the claims are successful, a franchisor could find its ability to access franchisee data drastically reduced.

Data transfer restrictions are especially challenging for international franchise systems because of the number of different legal entities that may be sharing data internationally. In this fast-evolving space, selecting the right compliance mechanism requires careful consideration of an organization’s specific circumstances. This is an area where regulators are paying attention.

Action: Map your international data flows within your organization and ensure that each transfer has a legal basis. Consider which mechanism is best suited to your organization. Maintain awareness of the legal status of these mechanisms and watch out for any existing or potential legal challenges.

2. Data Governance

The GDPR introduces new features designed to ensure there is appropriate “data governance” for businesses operating in Europe or targeting European consumers. Like the Sarbanes–Oxley Act, data governance regulation was introduced following a financial crisis, and puts a similar emphasis on the prevention of non-compliance through regular audits, policies, procedures, training and implementation.

These measures include requirements to document data processing operations, conduct risk assessments, and introduce European terms into your standard contractual language, both within the franchise system and with vendors. Compliance needs to be active and demonstrable, which means employee training and awareness will play an important role.

Action: Update any new franchise agreements and review previous agreements as they come up for renewal. Update your manual and put in place policies and procedures relating to data and cyber risk management. Implement training and staff awareness programs around data risk across all levels of franchise, for any employees with access to personal data. Remember, data privacy failures on the part of a franchisee could result in a franchisor being fined.

3. Dealing with Cyber-Attacks

Cyber-attacks and data breaches are increasing in number and scope, affecting organizations of different sizes and operating in different sectors. As is evident
from the recent breaches, even the most sophisticated
tech companies can be affected. As the rate of breaches
rises, companies face consequences not only for failing
to keep information secure, but also for how they handle
their incident response.

When the GDPR comes into effect, organizations in
every economic sector will have just 72 hours from the
moment of discovering a breach to report it to regulators.
For many franchised organizations, this could include
data breaches affecting a franchisee, or even a supplier to
a franchisee. 72 hours is a very short time for complex
organizations to get to the bottom of an incident and plan
their remediation, but an organization can be slapped
with significant penalties for failing to report, even if
ultimately it was not responsible for the breach.

Beyond legal responsibility, a breach could also harm
a franchisor’s brand, in particular if remedial actions and
legally required notifications are slow to materialize. It is
therefore imperative for all franchisors to create and test
incident response plans before an event actually occurs.

Action: Ask yourself, do we have a disaster incident
response plan which addresses cyber incidents and data
breach risks? If you don’t, prepare one so that relevant
stakeholders are better placed to react to such incidents,
and rehearse it. Assign responsibility for data security
more broadly: Whether your team is led by personnel
from the legal department, information technology,
human resources, or a combination thereof, all will need
to be involved.

4. Obtaining proper notice and consent

Privacy laws across the world already require
organizations to notify customers or employees before
collecting their data, and to obtain some form of
consent for the intended use. The exact form of notice
and consent varies by jurisdiction. Under the GDPR,
however, the rules relating to consent will become
much stricter – businesses cannot rely on pre-ticked
boxes or inactivity to indicate consent, and consent must
not be “bundled” with other written agreements or
declarations.

Providing proper notice and obtaining consent
is especially tricky in a franchised model, where the
responsibility for collecting data and/or databases may
be shared between the franchisor and franchisee. If a
franchisee fails to abide by the appropriate notice and
consent rules when it collects data from customers,
the franchisor could be in breach if it uses the data.
Franchisors and franchisees should think through these
arrangements at the outset to maximize control and
clarity over data collection notice procedures. Franchise
agreements and manuals should clearly identify who has
rights to use collected data and for what purposes.

Not only do these measures ensure compliance,
they provide franchisors the opportunity to build
consumer trust. Data that is collected in the wrong way,
without appropriate notice or consent, could be tainted,
preventing a franchisor from using it down the line for
its intended purposes.

Action: Review your organization’s existing privacy
notices and methods of obtaining consent. Track the
way personal data is collected and flows through your
organization to identify all the points where individuals
should be notified.

5. Respecting the rights of individuals

Privacy laws generally (and to differing extents) give
individuals control over their personal data. Perhaps
the most significant innovation in the GDPR is the
introduction of new rights for individuals over their data
as well as the strengthening of existing rights so as to
provide individuals with unprecedented control over how
organizations use their data. Some of what is being asked
under GDPR – for instance, in certain situations, to be able
to supply a person’s data to a competitor in a compatible
form – has never before been imposed on businesses. As
with many of the issues identified in this article, scaling
these systems across any organization, and in particular
across a franchise system, will be no simple feat.

But these new rights also present an opportunity
for businesses to distinguish themselves from their
competitors in the way they allow users to exercise
control over their data. For franchise systems, this will
require an acrobatic level of coordination across the
enterprise. Projecting a unified brand in the digital
world will depend on getting this coordination right.

Action: Conduct a gap analysis to identify where
operational changes are needed. Implement strategic
planning that focuses on user control as a key asset.
Ensure that any user interfaces are accessible and easy to
use.

Conclusion: Plan for Data Protection

Changes to data privacy laws and consumer
expectations do not need to stand in the way of the
promises of new technology. Rather, by thinking ahead
and carefully understanding how your organization
relies on data, your franchise system can thrive in
this volatile environment. When the GDPR comes
into effect, organizations that fail to adapt will see a
landscape marred by very high level risk. Those that
plan ahead will reap the rewards.
Joint Employer Update: Does the Department of Labor’s Move Signal A New Era?

By Keri A. McWilliams, Nixon Peabody LLP

By a press release issued on June 7, 2017, the U.S. Department of Labor announced the withdrawal of certain Obama-era informal guidance on joint employment and independent contractors. See https://www.dol.gov/newsroom/releases/opa/opa20170607. The withdrawal of this guidance signals a shift in the focus of the Department of Labor, which at first glance could provide some comfort to franchisors that have been concerned about liability based on joint employment theories. The practical effect of the withdrawal of the guidance may be limited, however.

What Has Changed?
The withdrawal specifically applies to Administrator’s Interpretation No. 2015-1, issued in July 2015, related to misclassification of workers, and Administrator’s Interpretation No. 2016-01, issued in January of 2016, which outlined a revised and expanded understanding of joint employment under the Fair Labor Standards Act ("FLSA").

Administrator’s Interpretation No. 2015-1 emphasized the Administrator’s view that most workers are employees under FLSA’s broad definition. Although the common law test for employment analyzes whether a worker is an employee based on a putative employer’s control over the worker, the definition of “employ” under FLSA includes “to suffer or permit to work,” which is a much broader standard. Under FLSA, the appropriate test is the so-called “economic realities” test, which considers the economic realities of the working relationship, including the following: Does the worker’s managerial skill affect the worker’s opportunity for profit or loss? Is the relationship between the worker and the employer permanent or indefinite? What is the nature and degree of the employer’s control? How does the worker’s relative investment compare to the employer’s investment? The Administrator’s Interpretation explained that the economic reality factors must be assessed in light of the FLSA’s intended expansive coverage for workers. That expansive reading caused concern in the franchise community that more potential liability for franchisors would follow for franchisee employees.

In Administrator’s Interpretation No. 2016-01, the Administrator articulated a more expansive view of the joint employment doctrine, generally. Specifically, the Administrator distinguished between “horizontal” joint employment relationships, where two or more employers have established or admitted relationships with the same employee, and “vertical” joint employment relationships in which an employee is directly employed by one entity (such as a staffing agency or subcontractor), but may be economically dependent on a separate entity with which it may not have a direct relationship.

“[R]emoval of the administrator interpretations does not change the legal responsibilities of employers under the Fair Labor Standards Act ... as reflected in the department’s long-standing regulations and case law. The department will continue to fully and fairly enforce all laws within its jurisdiction, including the Fair Labor Standards Act ....”

The Administrator’s Interpretation emphasized that the same expansive economic realities test that applies to determining whether a worker would be considered an employee, also applies to determining whether a joint employment relationship exists.

What Has Not Changed?
While the withdrawal is an important signal about the direction of the new administration, the practical effect of the withdrawal is not immediately clear. The short press release announcing the change specifically noted that “[r]emoval of the administrator interpretations does not change the legal responsibilities of employers under the Fair Labor Standards Act ... as reflected in the department’s long-standing regulations and case law. The department will continue to fully and fairly enforce all laws within its jurisdiction, including the
This move suggests that the Department of Labor will continue to consider the “economic realities,” but will apply the test in a more limited fashion. This would represent a shift back to the Department of Labor’s practice prior to the issuance of the withdrawn guidance—a time when franchisors felt more confident that they would not be considered the joint employer of their franchisee’s employees under the Fair Labor Standards Act absent exercise of significant control or influence over the employment relationship.

However, uncertainty remains. The concept of joint employment arises in various statutes and in various jurisdictions throughout the country, and the standards for joint employment have always varied based on the specific jurisdiction and the statute at issue. The withdrawal of the guidance does nothing to resolve that jurisdiction-by-jurisdiction variation.

If the now-withdrawn guidance helped establish a more expansive legal framework in states that utilize the economic realities test, there is no guarantee that the withdrawal of the guidance will prompt states to abandon that legal framework. Franchisors will still have to contend with more expansive views of joint employment in some jurisdictions.

Similarly, the removal of the non-binding guidance does not affect joint employment in the labor-law context. The decision in Browning-Ferris Industries of California, Inc., 362 N.L.R.B. No. 186 (Aug. 27, 2015), currently on appeal before the United States Court of Appeals for the District of Columbia Circuit, concluded that even unexercised, indirect control over an employee can give rise to joint employment status under the National Labor Relations Act. While the press release signals a sea change at the Department of Labor, franchisors must continue to be vigilant as the legal standards for joint employment continue to evolve.

How to Build an In-House Legal Department at a Franchisor

By Timothy A. Brinkley, Quarles & Brady LLP

Franchising has proven itself to be a highly attractive business model both to newcomers to the industry and to investors who acquire existing franchisor companies with aggressive ideas for further growth. One of the attractions of franchising is the chance to increase income and profits with less overhead than a traditional business. For many in the industry, the ideal scenario is that franchisee capital fuels the growth of the system while the company expends little capital of its own and seeks to streamline its operations, focusing on core competencies and management of the brand. Put most simply, this “pure” franchising model of business relies more than anything on creating and protecting a trademark and enforcing franchise agreements that license the use of that trademark. The legal function within the business, therefore, is mission critical.

Legal compliance and support are seen as cost centers to business owners, but in the franchising industry in particular the company’s legal counsel are also seen as necessary partners to help shepherd the company on its path to growth. No matter its current size and geographic footprint, a franchisor company planning for growth should give careful consideration to how it will meet its legal needs going forward. It should look carefully at the legal help that was needed and used to get it to its current point and how it can be better optimized. Typically a mix of in-house and outside counsel will be the sweet spot for a growing franchisor company. Getting the mix right is more of an art than a science, but the company’s past experience with legal counsel can often guide their decisions for the future.

Startup Franchisors

Those who venture into franchising for the first time are often enticed by the ability to grow their footprint and brand recognition at a much faster pace than they could through borrowing money or attracting equity investors to build more company-owned outlets. While they also have to worry about things like supply chain, store design, marketing and operations manuals, one of the first things they ask about and encounter is the legal cost involved in creating a franchise disclosure document and otherwise complying with federal and state franchising laws and regulations. There is good
reason for startup franchisors to be concerned about legal issues early on because franchising is highly regulated and early mistakes can have sometimes catastrophic consequences. While the scope of the FDD and regulatory compliance required can be an initial shock to some, it does not dissuade all because the attractiveness of the business model remains strong despite the legal concerns and costs.

When business owners make the decision to franchise their concept, they often seek out a franchising attorney either before or shortly after they look for a franchise business consultant. The structure and nature of the disclosure and other regulatory requirements in franchising can actually help guide a startup company in putting in place the essential pieces of its franchise system. After the FDD is prepared, the company will still need to lean on its outside counsel to conclude the initial transactions with franchisees and others, and to deal with the growing pains of the system. Legal costs may constitute a higher percentage of overall costs in the early years than in later years because of the initial unfamiliarity with the industry’s legal requirements. In virtually all cases, the legal help at this stage will come from outside counsel and not in-house counsel.

As time passes and familiarity grows, a franchisor company will typically want to start moving some of the legal function in-house. The most logical place to begin is using administrative staff or paralegals to generate and issue non-negotiated franchise agreements and ancillary documents internally instead of sending each one to outside counsel for preparation. Outside counsel can assist in handing off this function when the time is right by ensuring that the internal personnel have updated forms and understand clearly how to complete the documents and when to issue them. Outside counsel can also provide training and specific instructions to internal staff on when and how to issue the FDD and collect receipts, and outside counsel can remain involved with negotiated agreements and dealing with franchise blackout periods during amendment or renewal of the FDD.

Franchisors in Mid-Life
Once the company has taken the cost-effective step of moving the issuance of franchise agreements in-house, it should regularly think about and assess what other legal functions can be brought in-house over time. A good outside counsel can assist in guiding its franchisor client in making these periodic assessments. As the system grows, the time and money spent on things like marketing, supply chain and operations will grow. Particularly for those who pursue a nearly 100% franchised system, marketing is one of the key responsibilities of the franchisor, and the company may want to begin moving some of the legal functions of marketing in-house at some point. Outside marketing counsel can train an in-house paralegal in some of the most repetitive tasks, such as adding appropriate disclosures to point-of-purchase advertising.

In-house staff may also be better positioned to watch for consistency across advertising platforms. As marketing becomes more diversified, it may make sense to add an in-house attorney with knowledge of marketing and trademark law so they can review things like trademark usage, coupons and other promotions, and radio and TV copy.

Supply chain needs differ depending on the type of franchised business, but many franchisors will need numerous agreements with suppliers and distributors by the time their system reaches an intermediate size. At this stage, there may not be enough work to merit a full-time in-house attorney or paralegal dedicated solely to supply and distribution matters, but if that is the case then a franchisor can consider using a general corporate in-house attorney or paralegal to handle this area as well as another area or two in which they can be trained. Outside counsel can provide form agreements, or a master set of terms and conditions, for the in-house staff to use, and outside counsel can be called upon when third parties insist on deviating substantially from the franchisor’s preferred language.

Mature Franchisors
Franchisors with hundreds of outlets and decades of experience will have a wealth of historical knowledge to draw on in seeking to calibrate the mix of in-house and outside legal resources that they use. The legal budget is often the overriding concern, and any repetitive tasks that necessitate the attention of an attorney or paralegal will typically be less expensive if done in-house. Very complex questions or transactions that arise infrequently are best handled by outside counsel if and when such issues arise.

Mature franchisor companies, like all mature companies, will have a broad array of employment law issues to address, and it will eventually make sense to have an in-house employment attorney, and perhaps paralegal as well, to handle the
These in-house staff can also help with general corporate compliance that is not specific to franchisors.

Some mature franchisors may be regularly involved in litigation at a level that is fairly predictable with respect to both volume and subject matter. The question of whether to hire in-house counsel as either litigation coordinators or active litigators will logically arise in those situations. Hiring an experienced litigator to oversee and coordinate outside counsel working on litigation can add a tremendous amount of value for companies who regularly experience a high volume of litigation.

An experienced litigator who is in regular contact with the general counsel and leadership of the company, and who has a good knowledge of its approach to litigation and settlement, will be able to respond quickly to outside counsel regarding the strategic and tactical decisions that need to be made during the course of every litigation. When there is a high volume of litigation or arbitration that takes place almost entirely in a forum that is near the company’s headquarters, it may even make sense to hire active litigators as in-house counsel, and some mature franchisors have taken this approach.

As always, the approach to handling litigation will depend on the facts and circumstances of each company. Franchisors with a larger number of company-owned outlets, for example, may expect a much higher volume of employment litigation that needs to be managed. Companies with a high volume of litigation can quantify and measure the success of their approach by tracking litigation costs, including collections or payments on judgments and settlements, over time.

It may be economical to have other legal disciplines in-house as well, such as real estate or international attorneys and paralegals. Mature franchisor companies that own the majority of the real estate where their outlets are located will almost undoubtedly want to have in-house real estate attorneys and paralegals to handle leasing, purchases, sales and construction matters. The system’s global footprint will typically dictate when it will be cost-effective to have internationally based in-house counsel. As the system initially expands overseas, in-house attorneys based at the franchisor’s headquarters can work with local outside counsel in the applicable countries as needed. Once the system has operations in a large number of countries in a region, it may be cost-effective to hire an in-house counsel in the region who will be in or closer to the time zone of their clients, able to travel around the region more easily, and more knowledgeable about local laws and customs. If the company has already established a regional office for other staff, then adding an in-house attorney there can help reduce reliance on local outside counsel who are often very expensive.

Other Considerations
Although franchise systems are very diverse, one reality for all franchisors is the FDD. Naturally, the question may arise of whether the FDD can or should be prepared in-house. When the FDD is prepared by outside counsel for franchisors who already have an in-house legal team, the in-house team usually acts as a liaison between outside counsel and the departments and personnel in the company that can provide the information needed to update the FDD. Since franchise laws and regulations are constantly changing, and new case law is being created on a regular basis, franchisors who decide to move preparation of the FDD entirely in-house should, at a minimum, ensure that their in-house franchise legal team is ready, willing and able to continuously stay up to date on those changes.

Some other issues that frequently arise with franchisor companies are franchisee defaults, encroachment disputes and franchisee bankruptcies. With experience, a franchisor and its legal team can improve how they address these areas. There may be an inclination earlier in the life of a franchisor company to always turn these matters over exclusively to the legal department. An alternative is to allow personnel from the business side who are well versed in these areas, and well coached and informed by the legal team, to work directly with the franchisees and attempt to resolve some of these issues without the need for excessive involvement from in-house or outside counsel. When this approach is successful, the legal team will only be needed to document the agreed settlement or resolution.

Conclusion
Franchisor companies come in all shapes and sizes, and there is not a one-size-fits-all approach to building an in-house legal department. Some companies, for example, may manufacture products or packaging that is used in their franchised outlets for reasons of efficiency or quality control, and legal needs will differ based on the nature of the franchise system. The franchise model, however,
requires a constant and relatively high level of legal compliance and support. Even in the thinnest and most efficiently operated franchisor companies, the need to protect trademarks and enforce brand standards will be at the core of what they do. For this reason, franchisor companies should spend more time thinking about and constantly reassessing the legal function within the company and the most efficient way to execute this critical role.

One Size May Not Fit All: Small Business Association Franchise SOP 50 10 5(I)

By Edith Wiseman, FRANdata


The New Franchise SOP eliminates the need for lender review. Franchisors and franchisees are now required to sign a uniform addendum: the SBA Addendum to Franchise Agreement (SBA Form 2462 in Appendix 9) (the “SBA Addendum”). The SBA Addendum is a one-size-fits-all instrument that cannot be altered in any manner whatsoever.

The SBA Addendum will apply and supersede any inconsistent terms contained in franchise agreements; namely involving: franchisor rights in connection with franchisee transfers of interests; valuation of franchisee assets if a franchisor exercises an option to purchase a franchisee’s personal property following default or termination; franchisee’s rights regarding real estate owned by a franchisee and used in the operation of the franchised business; control of a franchisee’s employees by a franchisor.

Although intended to reduce time and costs in franchise financing, the New Franchise SOP represents a significant change in SBA policy that dates back to pre-recession years.

Pre-Recession to the Present

Before the Great Recession in the late 2000s and early 2010s, in franchise lending, the SBA only concerned itself with “franchise affiliation” issues. In the SBA’s terms, franchise affiliation prevents a franchisee’s right to profit or sustain a loss commensurate with its efforts. Franchise affiliation was addressed by the SBA with a franchise agreement addendum that focused almost exclusively on diluting or eliminating restrictions on a franchisee’s right to transfer interests in its franchise. The SBA did not often concern itself with other issues seen in franchise agreements.

By 2009, the economy was receding and the SBA was experiencing unprecedented losses in its loan portfolio. The SBA reviewed its defaulted loans and determined that SBA lenders had failed to address many significant issues in the SBA loan evaluation and approval process. To prevent similar future losses, the SBA expanded the scope of what lenders were required to review and imposed more requirements on lenders to address franchise affiliation concerns. The SBA also deemed ineligible for SBA financing all borrower applicants that operated a passive or inherently speculative business. The most well-known example of business ineligibility in franchising is the Sola Salons and Salons by JC franchise systems, which were removed from the Franchise Registry in 2009 because the SBA determined that the business format was passive and thus too risky for the SBA’s involvement. Since then, the SBA has established a Standard Operating Procedure revision nearly every year to address the SBA’s current posture toward franchise financing.

The New Franchise SOP

The New Franchise SOP could be said to represent a step backward to pre-recession years, when the SBA’s policies for reviewing franchise loan applications were fewer. But fewer does not necessarily mean better for lenders and borrowers.

The New Franchise SOP may have unintended consequences. For example, the SBA Addendum does not address all franchise affiliation concerns and cannot possibly address all provisions contained in franchise and related agreements that could potentially be problematic for lenders. As a result, lenders are forced to shoulder more risk, which in turn is and will likely continue to lead to less access to capital for franchise industry borrowers.
In addition, the New Franchise SOP requires lenders to determine whether a business is in fact a franchise, according to the Federal Trade Commission’s guidelines. This is something lenders have never been asked to do and are not familiar with doing. As a result, some borrowers are being pushed by cautious lenders to sign the SBA Addendum even though they are not in fact business format franchises.

The SBA has also expanded its business eligibility rules to effectively exclude businesses that target a subset of the population. And business eligibility, which was previously determined by the SBA under its franchise review determination, is now being determined by lenders.

All of these changes seem to reflect a shift in the SBA’s approach to franchise financing which may streamline the process and could ultimately be problematic for the franchise lending industry.

In fact, due to both franchise and lending community reaction, the New Franchise SOP was revised to temporarily allow franchisors to use previously negotiated SBA addendums from either 2015 or 2016 (SOP 50 10(H)). About one-third of all franchisors have elected to take advantage of this opportunity. It is uncertain for how long the SBA will allow this.

Specific Concerns Regarding SOP 50 10 5(I)
Below are some sections within the New Franchise SOP which, upon a survey conducted by FRANdata, were found to raise concerns by the franchise and lending communities:

1. Change of Ownership

   - The SBA Addendum limits rights when the proposed transferee is a family member of a current owner.

   - There is a lack of clarity around how to define “family member.”

   - Because a franchisor’s rights are limited in a partial transfer, this makes it more difficult for a franchisor to require an entity to have a principal operating partner with experience in that type of business.

2. Consent to Transfers

   - The SBA Addendum says that if a franchisor’s consent is required for any transfer (full or partial), the franchisor will not unreasonably withhold such consent. And further that upon an approved transfer, the transferee will not be liable for the actions of the transferee franchisee.

   - There is some uncertainty regarding what would be considered “unreasonable” refusal of consent if the franchisor places certain relevant business conditions on approval for a transfer. These would include conditions such as requiring that the transferee meet a franchisor’s current standards for approval of new franchisees, or have the financial ability to undertake and assume both current and ongoing obligations.

   - Regarding a transferor’s ongoing liability, franchisors are concerned that the SBA Addendum eliminates the transferor’s guaranty. Franchisors agree that there is a need for the transferor to remain as a guarantor, especially if the transferee is not in the same financial position as the transferor. Without a continuing guaranty, franchisors must apply a higher standard for creditworthiness to the transferee.

3. Real Estate

   - The SBA Addendum says that if the franchisee owns the real estate where the franchise location is operating, the franchisee will not be required to sell the real estate upon default or termination.

   - In the event of a termination of a franchise agreement, the SBA Addendum could impact a franchisor’s ability to protect proprietary brand identity and trade dress.

4. Franchisee Employees

   - The SBA Addendum prohibits franchisors from directly controlling (hiring, firing or scheduling) a franchisee’s employees.

   - As written, this section implies that if not expressly prohibited, franchisors in fact get involved in their franchisees’ employment matters. There is a presumptive link of joint employment.

Conclusion
The franchise world will watch with interest on whether the New Franchise SOP lives up to its intended purpose of simplifying the borrowing process for franchisee borrowers. And the franchise and lending communities will be watching as well to see if their concerns as outlined above are realized.
The Push for Class Action Reform
By Cal Everett, Hooters of America, LLC

While scalability is the core of the franchise model, scalability in litigation is the bugaboo that keeps many members of the franchise bar awake at night. Class action litigation is often long, complex, expensive, and public. A logical consequence of a system with such high stakes is that the people and institutions with the most to lose within that system, would seek to change it.

That is precisely what is happening right now in Washington D.C. Class action reform legislation, bolstered by an aggressive lobbying effort by the U.S. Chamber of Commerce, has been making its way through Congress. It is impossible to handicap the chances of this specific legislation becoming law, but the current Republican Party control of the White House and both houses of Congress has created a fertile environment for reform efforts. Business leaders argue that reform is necessary to create a more favorable environment for innovation and economic growth. Advocates for maintaining the status quo passionately contend that the system works as designed to hold the powerful accountable in a way that an individual plaintiff would be unable.

Advocates for reform describe the current class action litigation system as wrought with unscrupulous, serial plaintiffs who have unhealthy relationships with the attorneys representing them. They say this system serves the singular purpose of making plaintiffs’ lawyers rich. In a February 14, 2017 open letter to Congress, Lisa Rickard of the U.S. Chamber of Commerce’s Institute for Legal Reform, explained: “Every year, these proceedings cost American businesses millions of dollars in legal fees, divert finite resources away from true victims, and often result in settlements where nobody wins, except the lawyers.” Letter from Lisa A. Rickard, Pres., U.S. Chamber Institute for Legal Reform (February 14, 2017), https://www.uschamber.com/letter/hr-985-the-fairness-class-action-litigation-act-2017.

One of the principal arguments by supporters of reform is that activist judges ignore fairness requirements and certify classes that should never be allowed to move forward. According to this narrative, classes are being certified where there is no evidence that class members experienced the same alleged harm as the class representative. This issue is so meaningful that it is the first operative clause in the proposed Fairness in Class Action Litigation Act of 2017 (FICALA). The proposed bill provides:

A Federal court shall not issue an order granting certification of a class action seeking monetary relief for personal injury or economic loss unless the party seeking to maintain such a class action affirmatively demonstrates that each proposed class member suffered the same type and scope of injury as the named class representative or representatives.

Fairness in Class Action Litigation Act of 2017, H.R. 985, 115th Cong. § 103 (2017). FICALA would also require that courts issue an order attesting that each class action meets the requirements for class certification in its entirety.

The perception that plaintiffs’ lawyers are opportunistically using class action litigation for pecuniary gain also underlies the reform effort. FICALA has numerous provisions aimed at limiting the plaintiffs’ bar. For example, the bill would not allow a class to move forward if the attorney was related to any class member. Id. It also would limit when and how much class counsel can be paid. Proponents of these limitations explain that they would ensure that the windfall of any class action litigation would benefit the plaintiffs, rather than their lawyers. See The FICALA Fix For Litigation Abuse http://ccjc.org/us-chamber-institute-for-legal-reform-the-ficala-fix-for-litigation-abuse/. Similarly, FICALA would prohibit plaintiffs from using the same class counsel more than once. Fairness in Class Action Litigation Act of 2017, H.R. 985, 115th Cong. § 103 (2017). Another currently pending bill, The “Lawsuit Abuse Reduction Act of 2017” would amend Rule 11 of the Federal Rules of Civil Procedure to require judges to sanction attorneys who file frivolous lawsuits.

Opponents of reform say the system works and empowers the weak to hold the mighty accountable. One of the staunchest opponents of the currently proposed legislation is the ABA. Thomas Susman, the Director of the ABA’s Governmental Affairs Office, sent a letter to Congress urging them to consider the reform bills carefully. The letter explained succinctly, “Class actions have been an efficient means of resolving disputes.” Letter from Thomas M. Susman, Dir., American Bar Association Governmental Affairs Office, 2 (March 6, 2017), https://www.americanbar.org/content/dam/aba/uncategorized/GAO/Class%20Action%20Letter%202017.authcheckdam.pdf. Mr. Susman went on to explain that not allowing issues to be resolved on a class basis will further clog already overwhelmed court dockets. Id.

The ABA also elucidated its belief that there is already an appropriate process for making changes to the class action systems through the Judicial Conference and the courts themselves, and that changing class action rules through legislation would be an unreasonable usurpation of the judicial power by the legislature. The ABA letter states, “We urge you to allow [the existing process] for examining and reshaping procedural and evidentiary rules to evolve as provided in the Rules Enabling Act, which reflects a healthy respect for the Separation of Powers doctrine and the role of the federal courts in determining their own rules.” Id.

As noted above, the relationship restrictions in the FICALA would prohibit plaintiffs from using the same class counsel more than once. FICALA detractors say that this provision would place unreasonable restrictions on the ability of aggrieved parties to choose the lawyers they trust the most. Institutional investors who often develop meaningful long-term relationships with the attorneys that represent them would be particularly affected by this restriction. These FICALA opponents argue that these restrictions may not only be imprudent, but they may also unconstitutionally limit due process. John C. Coffee, How Not to Write a Class Action Reform Bill, The CLS Blue Sky Blog (Feb. 21, 2017), http://clsbluesky.law.columbia.edu/2017/02/21/how-not-to-write-a-class-action-reform-bill/.

Reform opponents say that the requirement that all class members have the same injury would make it nearly impossible for many plaintiffs to get the relief to which they would otherwise be entitled. These opponents point to examples of retired NFL players who suffer from different symptoms as a result of head trauma, or to plaintiffs that sued the Veterans Administration claiming a myriad of differing injuries. In these examples, the injuries varied, but the relief sought did not. This argument highlights the central premise that class action litigation exists to provide a mechanism to allow aggrieved parties to get not only monetary relief, but also important injunctive relief by using the leverage of the class.

FICALA critics also argue that the bill creates administrative hurdles and breeds inefficiency. They state the FICALA provisions that permit an automatic stay during the pendency of certain issues, or the provision that would allow defendants to appeal class certification orders would further delay an already lengthy process. Letter from Elizabeth Chamblee Burch, Chair of Law, The University of Georgia, School of Law, 6 (Feb 13, 2017), http://lawprofessors.typepad.com/files/burch-final-comments-on-fairness-in-class-action-litigation-act.pdf.

No matter the outcome of the specific legislation described above, the issue of class action reform will continue to be hotly contested. The Judicial Conference and the courts themselves will likely continue to be drivers for change, albeit far more subtly and gradually than if changes come through the legislature. With or without change, the central arguments of fairness and efficiency will persist, and members of the franchise bar will likely continue to lose sleep over the issue of class action litigation.
Member-at-Large positions are as follows:

1. Gary Batenhorst, a partner with Cline Williams Wright Johnson & Oldfather, LLP in Omaha, Nebraska. Gary serves as the Editor-in-Chief of the Franchise Law Journal and was previously both an Associate Editor and Topic and Article Editor for the Journal. Gary also wrote chapters in the Forum’s publications: Collateral Issues In Franchising; Beyond Registration and Disclosure and Covenants Against Competition in Franchise Agreements, 3rd Edition;

2. Michael Gray, a partner with Gray Plant Mooty in Minneapolis, Minnesota, nominated for his second, and final, three year term. He was the co-editor of Covenants Against Competition In Franchise Agreements, 3rd Edition, serves as the Forum’s Finance Officer and will be co-Chair of the 2018 Annual Forum in Nashville;

3. Dawn Newton, a partner with Donahue Fitzgerald in Oakland, California, nominated for her second, and final, three year term. Dawn received the Forum’s Future Leader Award in 2010. She currently serves as the Forum’s Women’s Caucus Officer and is the incoming Program Officer, was co-organizer of the Forum’s Community Service Event for several Forums, and is co-editor of the forthcoming Forum publication The Annotated Franchise Agreement. Dawn is the co-Chair of the 2017 Annual Forum in Palm Desert; and

4. Elizabeth Weldon, a partner with Snell & Wilmer in Costa Mesa, California. Liz is the current Director of LADR, where she participated in the LADR Task Force Review and initiated the monthly case updates. She was previously a member of the LADR Steering Committee and is a chapter author for the forthcoming Forum publication The Annotated Franchise Agreement.

An election to fill these positions will take place at the Forum’s Annual Business Meeting, which will be held in conjunction with the 40th Annual Forum on Franchising on Friday, October 20, 2017 in Palm Desert, CA.

Speaking of the Annual Meeting, if you have not registered for the Annual Meeting, I urge you to do so today. Our Thursday night event will celebrate the Forum’s 40th birthday at Jackalope Ranch. Jackalope Ranch represents one of the best southwest inspired venues, sitting on a beautifully landscaped 6.5 acre property which offers authentic California Ranch Cuisine and classic bar-b-que, as well as an indoor saloon, outdoor palapa and evening entertainment. Friday’s event will be an “Old Hollywood” reception and dinner and will take place at Greta Garbo’s former estate at La Quinta. La Quinta is nestled beneath the beautiful Santa Rosa Mountains, offering championship golf courses, an award-winning spa, 41 pools and five outstanding restaurants, offering the ultimate Palm Springs getaway.

Finally, please keep in mind that the Forum will have several new publications available in time for the Annual Meeting. I previously informed you that our new publications Exemptions and Exclusions under Federal and State Franchise Law, edited by Beata Krakus and Leslie Curran and The Fundamentals of Franchising - Canada, Second Edition, edited by Larry Weinberg and Peter Snell will be available for purchase at the Forum.

As always, I welcome your feedback on all aspects of Forum life. I may be reached at Karen.Satterlee@hilton.com.

The nominated candidates for the four Member-at-Large positions on the Governing Committee of the Forum on Franchising are:

1. Gary Batenhorst of Cline Williams Wright Johnson & Oldfather, LLP
2. Michael Gray, Gray Plant Mooty
3. Dawn Newton, Donahue Fitzgerald
4. Elizabeth Weldon, Snell & Wilmer
As hard as it is for me to believe, a year has passed since I was appointed the Editor of The Franchise Lawyer, and we are going to press on the fourth issue I have had the privilege to edit. A talented slate of writers cover a broad range of topics that will be of interest to a variety of practitioners, from new NASAA commentary on Item 19 Financial Performance Representations, to the Department of Labor’s withdrawal of regulatory guidance on joint employment issues, to the recent SBA Standard Operating Procedure intended to streamline franchise lending, to data protection issues in the EU. And we have advice on building an in house legal department from a veteran in-house counsel, as well as a discussion of potential class action reform. We hope you find this issue interesting and useful.

And, we hope to see many of you at the 40th Annual Forum on Franchising in Palm Desert in October. The Annual Meeting presents opportunities to learn and network with fellow practitioners from across the franchise world. Please look for me and the editorial team, and don’t hesitate to offer to write.
EXEMPTIONS AND EXCLUSIONS
UNDER FEDERAL AND STATE FRANCHISE REGISTRATION AND DISCLOSURE LAWS

While all franchises are required to register and file disclosure statements, there is significant variation among states and also among laws at the federal level. Following a uniform format for ease of reference, this book reviews the exemptions that are available under federal and state laws.

Edited by Leslie Curran and Beata Krakus
Forward by Karen Satterlee