The Franchise Disclosure Document

What can you learn from the Franchisor's FDD?

History of the FDD

Prior to the 60s, there was little franchising momentum in the US. However after the success of McDonald's, many other companies began to franchise their concepts and the franchise industry expanded rapidly. In 1979 the Federal Trade Commission's FTC Rule became effective. This rule required all franchisors submit to all potential franchisees a document called the Franchise Disclosure Document or FDD. (This was referred to as the Uniform Franchise Offering Circular or UFOC prior to a change in 2008.) The purpose of the FTC Rule (manifested in the FDD) was to provide enough information so the prospective franchisee could make an informed decision about purchasing the franchise.

The FDD serves as a protection for the individual against making a decision based on information not supported by fact. The FTC Amended Rule requires franchisors provide the FDD to the prospective franchisee at least 14 calendar days before the prospective franchisee signs a binding agreement with, or makes any payment to, the franchisor or affiliate in connection with the proposed franchise sale. A franchisor's FDD must be updated on an annual basis, or sooner if certain conditions are met.

Here are some of the items a FDD must contain:

History and Experience. 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 any fairly recent litigation or bankruptcy history for either.

Financial Factors. The company must disclose to you the relevant financial terms of the franchise opportunity. 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.

Obligations and Restrictions. 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.

Other Considerations. 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.

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

Earnings Claims. 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.

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	Oregon
Indiana	Rhode Island
Maryland	South Dakota
Michigan	Virginia
Minnesota	Washington
	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.