

# FRANCHISE LAW INSIDER™

A Publication Reviewing Recent Franchise Developments

2nd Quarter 2003

**“We are what we repeatedly do.  
Excellence, then, is not an  
art but a habit.”**

*Aristotle*



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## **CALIFORNIA MOVES TO “RISK-BASED REVIEW” OF FRANCHISE FILINGS**

**C**alifornia, the first state to enact franchise registration and disclosure laws, has made a major shift in the ways in which it will handle future filings.

From now on, California will process all franchise filings based on an analysis of the risks presented to prospective Franchisees in connection with the offering: Those filings which indicate a low level of risk will generally receive a short review to determine that fundamental filing requirements have been met and to determine if long review is appropriate. Those filings for which a greater level of risk may be evident will receive a more detailed (long) review consistent with the procedure traditionally used in California.

This article explores the background of this shift in approach, some of the details associated with the new procedures and what they mean for Franchisors in connection with their filings in California over the next few years.

### **Background**

In 2002, the Franchise Law Committee (“FLC,” a standing committee of the California State Bar’s Business Law Section, co-chaired by Lori Lofstrom and consisting of attorneys who practice extensively in the franchise law area and with members who represent Franchisees as well as Franchisors) made a decision to

consider possible changes in the processing by the Department of Corporations (the “Department”) of various franchise filings.

After extensive study and discussion, including research and drafting by a subcommittee, of which David Holmes was the chair, and a unanimous Franchise Law Committee vote (with one abstention), the FLC recommended a change in the Department’s current office policy from full review and comment on all franchise filings to a limited review in most cases.

This change was judged to allow the Department to significantly concentrate its resources into a more effective and efficient system focused on enforcement against non-compliant Franchisors, rather than the prior system, which required the Department to review and analyze UFOCs from essentially the entire population of Franchisors seeking to do business in California. This change will bring California in line with other registration states that have, over recent years, formally or by office policy, modified or eliminated their UFOC review procedures, including Hawaii, Indiana, Michigan, South Dakota and Wisconsin.

In connection with preparing this recommendation, FLC representatives conducted detailed interviews with

### **In this issue...**

California Moves To Risk-Based Review of Franchise Filings .....	1
Permit Us To Introduce Maria Antolos .....	4
International: Intellectual Property & Trademark Protection .....	5
Examining the Risks & Benefits of Using Franchise Brokers .....	6

FRANCHISE LAW INSIDER™ is published to provide our clients and friends with information on recent legal developments affecting the franchising world. The articles and/or opinions presented are necessarily of a general nature and should not be construed as legal advice or opinions on specific facts.

We'll be happy to provide additional information regarding any of the articles contained herein, or to discuss how they may apply to your situation. We invite your comments, questions, or any short articles of a pertinent nature for possible inclusion in a future newsletter. Please contact our offices if you're interested.



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*Continued from previous page*

personnel in supporting an increase in office or complaints as a result of their changes. The regulators contacted also reported that the number of stop orders issued by the states has not increased and that the transition process had basically been a "non-event," other than the reduced paper work associated with the old pre-review.

One typical regulator noted that due to the new review policy, they were forced to focus on the larger material items in the UFOC, such as the financial statements and general content of the UFOC (that each Item was present and addressed). All in all, this regulator reported that they were very happy about the change in office policy in that it has made their jobs "easier and more efficient."

Based on the recommendations of the FLC, and these reports of experiences in other states, the Department of Corporations, at the end of 2002, made an office policy decision to move to a system of risk-based review of all franchise filings. Critical in this decision was a decision to focus resources on situations where significant risks exist for prospective Franchisees, and to thereby free up resources for enforcement actions against Franchisors who clearly violate the California Franchise Investment Law.

As a result of this decision, the Department requested input from the FLC as to the appropriate administrative procedures necessary to implement this new system and the FLC subcommittee reached consensus on the recommended procedures, which were transmitted to the Department at the beginning of this year. These procedures are discussed in more detail below.

### **Details**

First of all, it's important to understand what has not changed in California's approach to franchise filings. Most broadly, there has been no change in a Franchisor's obligation to file applications for initial registration,

renewals, pre- or post-effective amendments, notices of negotiated sale, disclosures with respect to material modifications or otherwise.

### **Specifically**

(a) pre-sale disclosure to prospective franchisees will remain mandated;

(b) copies of UFOCs and appropriate notices will continue to be filed with the Department, and all filing fee requirements remain;

(c) California - specific language will continue to be required in UFOCs, most notably in Item 17;

(d) the Commissioner can still require escrows, impoundments, guarantees, etc. as appropriate based on a Franchisor having inadequate financial resources;

(e) the Commissioner will retain the authority to issue stop orders; and

(h) Franchisees will retain all rights to bring private actions for violations of the CFIL.

Put in terms Franchisors will understand, California has not become a "postcard" state, such as Florida.

What has changed then? The administrative procedures involved in reviewing franchise filings.

Traditionally, all franchise filings in California were subject to extensive review, irrespective of the degree of risk that might be present from a prospective Franchisee's standpoint. This often resulted in practitioners receiving diverse treatment of filings, dependent on the office or examiner

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*Continued on page 3*

involved, or other factors seemingly impossible to predict. One renewal filing, for example, might be approved with no comments within 24 hours, while another might consume weeks or months in comments; an initial registration filing might be approved (again without comment) in as little as 10 days, while an essentially similar filing might take months to receive approval, even in the absence of substantive problems related to financials, with comments focusing on issues such as grammar, syntax, formatting, etc.

In theory, that has now changed. All filings will be subject to a short review to verify that fundamental filing requirements have been met and to determine if long review is appropriate. If certain criteria are identified (red flags) during the short review, the filing may be designated for a more detailed (long) review consistent with current review standards.

*Note that **this is not a mechanical process**. While the vast majority of filings will receive short review (to put it in modern terms, the “default position” is short review), the presence, in any filing, of a particular number of criteria for long review may or may not justify long review, bearing in mind a balance between the policy objectives of re-allocation of the Department’s resources (as discussed above) and appropriate review of filings which may present greater risks.*

The fact that a particular filing may not have any of the criteria for long review present does not mean that short review will always be mandated. First, some number of filings will be subject to long review at random, on the IRS model, to assure that all filings are appropriately prepared by practitioners. Second, exceptional situations may exist where a long review seems appropriate on the merits, in which case the examiner will first discuss the matter with his/her supervisor.

Mature judgment and discretion on the part of examiners will be required, consistent with the policy of focusing limited resources (the long review process) on situations where there seems to be a greater risk, and the general policy of providing short review in most instances. In doubtful situations, examiners should specify long review only after discussion with the examiner’s supervisor.

### **Content of the Short Review**

The FLC has recommended to the Department that all filings be subject to the following:

1. A brief review to determine that each of the items has, in form, been addressed. That review will not include a detailed (“drill down”) substantive review of UFOC items to determine if the content of items have been fully and completely answered. For example, the examiner would verify that Item 11 is addressed in the

UFOC, not that all of the detailed sub-items in Item 11 have been fully answered.

2. Verification that all papers normally accompanying a filing are present and appropriately completed.
3. Verification that California-specific language is present.
4. Review of financial statements to determine if an escrow, fee deferral or other special financial arrangements are appropriate and require compliance as necessary.
5. A judgment as to whether any “red flags” merit long review, as detailed below.

### **Criteria for Long Review**

Criteria suggested by the FLC to the Department, and which would result in long review, include the following:

1. Absence of a currently effective franchise registration in California or another “registration” state.
2. Pending court and/or administrative actions, or judgments within the last 10 years, by the Federal Trade Commission, California or any other state, claiming a material violation of laws by the Franchisor, any affiliate or predecessor, or any of the Franchisor’s current officers and/or directors.
3. A significant number of pending lawsuits, or judgments within the last 10 years, or complaints by Franchisees lodged with the Department, claiming material violations of law by the Franchisor, etc.
4. The UFOC is not accompanied by independently audited financial statements (as distinguished from reviewed or compiled statements), or includes any “going concern” or other qualifications/reservations by an auditor.
5. The Franchisor is currently the subject of a bankruptcy proceeding.
6. Item 3 indicates any criminal convictions, or pending criminal matters, concerning the Franchisor, etc.
7. The Franchisor’s audited financial statements are such that an escrow (or similar requirements such as fee deferral or a bond) is imposed.

### **Matters to Not Be Generally Considered in Long or Short Review**

Based on past experiences, a number of recommendations were also made as to matters which had been considered by examiners in the past but which seemed to involve a misallocation of resources under a risk-based review analysis and are generally not appropriate for detailed review by examiners.

1. The use of “plain English,” while a worthy goal, is not a high priority for an examiner’s time. Analysis of language should be limited to instances where a paragraph is essentially unintelligible or otherwise inherently difficult for a reasonably intelligent business person to understand, and should not include detailed review or correction of grammar, syntax, vocabulary or otherwise.
2. Examiners should not request Franchisors to submit electronic copies of documents, so as to make changes for the Franchisor by the examiner. Any such changes are the responsibility of the Franchisor and / or its counsel.
3. Examiners should not, as a matter of course, “automatically” request waivers of automatic effectiveness, particularly shortly after the filing is made, since statutory and regulatory deadlines are intended to be followed. Requests for waivers of automatic effectiveness should be made only shortly before expiration of the review period (or on discovery of an actual significant problem with the filing) and then only when (a) factors outside the examiner’s reasonable control have made timely review or other resolution impractical and (b) approval has been given by an examiner’s supervisor. Use of the short review process should make compliance with statutory and regulatory deadlines by examiners the norm.

### The Future

California’s change to a risk-based short review/long review model has the potential for great significance. If applied as suggested (and senior officials with the Department have indicated that they are fully committed to the risk-based approach in franchising and other areas), it has the potential to significantly streamline franchise filings in California, while freeing up scarce resources for appropriate enforcement actions against the relatively few “bad actors” in franchising.

As one commentator noted, it may be analogous to the Highway Patrol concentrating its resources on drivers weaving down the freeway on New Years Eve, rather than spending time on Grandma driving to church on Sunday morning.

As always, we will have to remain watchful as to whether or not examiners fully implement the new policy, but the commitment by senior Department officials is good cause for optimism in that regard.

Holmes & Lofstrom, LLP, was actively involved with the Franchise Law Committee in working with the Department of Corporations on this project, with Lori Lofstrom acting as Co-Chair of the Franchise Law Committee during development and “fine-tuning” of the proposal and David Holmes being the originator of the idea. ■

## PERMIT US TO INTRODUCE MARIA ANTOLOS

**M**any of you have attended the IFA Breakfast meetings sponsored by H&L in both Orange County and San Diego and have provided positive feedback to us related to your attendance. We’d like to take a moment to introduce you to the person at H&L who is primarily responsible for making these meetings happen. Her name is Maria Antolos and she is the Administrative Assistant in our Long Beach office.

Maria has been with H&L for almost one year and in this brief time has settled in as an integral member of the H&L staff. She handles many tasks including, client relations, calendaring, office management, appointments, computer projects and many others. She is likely the first person that you will talk to when you call our Long Beach offices.

Maria grew up, and continues to reside in San Pedro. She attended Harbor Community College and now attends South Coast College Court Reporting School four nights a week. She hopes to complete these studies in 2 to 3 years and become a court reporter and is earning super grades as she goes! Maria is currently single, her hobbies include shopping, time at the beach and movies. Her mother is a native Italian and her father from Croatia, and interestingly, Maria speaks fluent Croatian. Among her favorite movies is When Harry Met Sally, her favorite kind of food is Italian and her favorite movie star, big surprise, Brad Pitt. Maria looks forward to her graduation from court reporting school, moving to the beach and finding “Mr. Right.”

We hope you’ve enjoyed “meeting” Maria. She holds things together for our firm and we don’t know what we would do without her diligent work ethic and contagious laugh!

## INTERNATIONAL INTELLECTUAL PROPERTY AND TRADEMARK PROTECTION

Of particular interest to Franchisors contemplating eventual expansion of their systems to foreign countries, is the U.S. implementation of the Madrid System, comprised of the Madrid Agreement and the Madrid Protocol. These two related treaties are administered by the World Intellectual Property Organization (“WIPO”), which maintains the International Register of Marks, and implements the Madrid System. Franchisors that plan to do business internationally will now have a chance to simplify trademark protection procedures and reduce associated costs involved in protecting their marks.

Beginning in November, 2003, the Madrid System will allow U.S. companies to file one standardized application (in English!) with the U. S. Patent and Trademark Office (“USPTO”), pay a single fee, and obtain a single registration in the applicant’s home country and also certain “priorities” covering underlying simultaneous national applications in each of the member countries selected by the applicant. Once approved, the registration will have one registration number and eliminate tracking multiple renewal dates.

On the other hand, Franchisors should be aware that there are some potential disadvantages: The registration is not an international registration independent of the filing in the applicant’s home country, but instead is a means of obtaining separate national registrations based on a pending or existing registration on file in the national trademark office of the applicant’s “home country”, or “Office of Origin”. Thus, the USPTO “home country” application’s or registration’s limitations as to a particular class (or classes) of goods and services will also limit the international registrations.

For further information regarding international trademark protection, contact Lori Lofstrom, head of our Intellectual Property Practice Group.

### General

#### *Middle East and Gulf Region:*

As you undoubtedly have noticed, interest in the Middle East continues at a fever pitch, and interest in business opportunities in the Middle East is also at a high level since the active phase of the Middle East war wound down. U.S.-based Franchisors have received invitations to attend and exhibit at MEFEX, self-styled as “The 1<sup>st</sup> International Franchise Expo for the Middle East & Gulf Region,” to be held December 2003 in Doha, Qatar. As the invitation

points out, the private sector in the Middle East is undergoing drastic diversification and liberalization. The group claims to be bringing together potential Franchisees from the region comprising Saudi Arabia, Kuwait, Lebanon, Oman, Qatar, Algeria, Bahrain, Iran, Jordan, Syria, United Arab Emirates, and Yemen. Of course, several of these

countries continue to be embargoed or otherwise problematic for US-based Franchisors. We have no specific knowledge about the validity or source of this invitation, but additional information can be obtained at [www.mefex.com](http://www.mefex.com)

#### *Italy:*

In late January, the Italian Senate announced that its 10<sup>th</sup> Commission was empowered to regulate franchising in Italy without the need for parliamentary approval. Some of the bill’s provisions are

still under discussion, and members of the Commission have proposed amendments, making changes likely before passage. The bill’s features include:

- A definition of a franchise which includes a contract granting, for compensation, a combination of IP and/ or industrial rights, know-how and commercial assistance, and the opportunity to be part of a franchising network;
- Mandating basic rights such as a written contract, the Franchisor’s agreement to test the formula for at least two years and with a minimum of 2 pilot units, half of which are managed by pilot Franchisees in one or more EU countries; a term minimum of three years. Note the rather unusual provision regarding test units, which may make it impossible for Franchisors to use Italy as their initial entry point into the EU.
- Requirements that the contract include specific features, such as: listing the exact fee and investment; the method of royalty payment; minimum turnover which the Franchisee must guarantee; location of Franchisee’s exclusive territory, if any; a description of the know-how to be provided; a description of the services to be provided by the Franchisor (planning, training, etc.); renewal, termination and transferability provisions.
- A disclosure requirement, with the following elements, among others: 30 days before the date of contract execution, the Franchisor must deliver a definitive draft of the contract as well as corporate information about the Franchisor, three years of balance sheets; documentation re: the trademarks; list of network members and of Franchisor’s points of direct sale; information about fluctuations of Franchisees in the last 3 years; descriptive list of litigation for the previous 3 years; and if possible, an economic forecast based on results of existing Franchisees. [Note that the requirement for

***“Franchisors that plan to do business internationally will now have a chance to simplify trademark protection procedures and reduce associated costs involved in protecting their marks.”***

*Continued on page 6*

“an economic forecast” raises significant questions in terms of possible earnings claims and that Franchisors will have to be particularly careful in this area to avoid possible liability.]

- Termination and compensation for damages to be available to the wronged party if one party provides false information [Note that this provision might allow for claims against the Franchisee if inaccurate information was provided in an application, for example.]; and
- Transition period: a transition period of one year for agreements already in force that do not meet these conditions. [source: Rinaldi e Associati, Italy]

Franchisors needing additional information regarding Italy, or international expansion generally, should feel free to contact us.

#### **Brazil:**

A new Civil Code, effective January 11, 2003, does not mention franchising expressly but has provisions that may

substantially affect franchise businesses. One potentially troublesome provision, Article 157, identifies a de facto “disparity” situation where (1) there is an inequality in the experience level of the contracting parties, and (2) one party assumes an obligation disproportionate to the other’s obligation. [Some analysts would argue that these elements are often present in franchising, at least with regard to unit Franchisees.] In such a case, the imbalance in obligations will be judged as of the time of execution of the agreement, and the deal will not be cancelled if a sufficient supplement is offered or the favored party agrees to a reduction of the counter payment. [source: Trench Rossi e Watanabe Advogados]

Since first time Franchisees may seek franchising specifically because they are inexperienced, discovery later that the franchise business is not as profitable as anticipated may provide a way out of the contract without triggering penalties. Our recommendation is that Franchisors considering entering the Brazilian market consult with us and local counsel to determine the extent of possible exposure prior to awarding subfranchise or unit rights. ■

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## EXAMINING THE RISKS AND BENEFITS OF USING FRANCHISE BROKERS

*By Michael H. Seid*

**U**sed intelligently and with care, brokers can provide value. They can be a source for new franchise prospects, and while they add a significant cost to the sales effort, one can argue that they earn their compensation only when someone closes on a deal. Brokers also can bring franchisors franchise candidates that for some reason were not attracted to the franchisor’s advertisements or other marketing efforts.

However, in these days of the Internet, with the abundance of lead generation sites and other techniques, not only can a well-structured and professional in-house franchisee sales force do as well for franchisors as brokers can, but it likely will do better at a lower cost and certainly at a significantly lower risk. Putting that debate off to another day, brokers can be a crutch for a weak inside salesperson who requires a presold candidate before he or she even can contemplate closing a sale. Equally, brokers can be a source of candidates to help a franchisor fill in a particular market.

### **Risks of Using a Broker**

There are certain risks associated with using a broker. The risk most often mentioned is the possibility that commissioned brokers will improperly share unit financial information with a prospective franchisee and make an illegal earnings claim. That risk, however, is not unique to third-party sales agents alone and can just as easily occur with in-house salespeople.

The rules governing the disclosure and registration of outside sales agents are reasonably clear and not new to franchising. The two main requirements are that:

- Brokers must be disclosed in Item 2 and, if necessary, Items 3 and 4 of the UFOC and,
- In certain states, brokers must be registered.

Many brokers and some of the franchisors that use them do not follow the rules. Part of the problem likely stems from the nomenclature used today in the industry. Few brokers refer to themselves as such any longer. They refer to themselves as coaches, advisers, sales consultants, lead generators, referral networks and the like. Indeed, a major brokerage firm’s web site proclaims in capital letters to prospective franchisees that it is not a broker.

Neither the regulations nor the regulators share that position. In an informal staff advisory opinion in November 1999, the FTC said, “there was no question” that a major consultancy that had asked for an opinion qualified as a broker under the rule. According to the FTC’s Guide to the FTC Franchise Rule “A ‘franchise broker’ is defined as any person who ‘sells,

offers for sale, or arranges for the sale' of a covered franchise (Part 436.2(j)), and includes not only independent sales agents, but also subfranchisors that grant subfranchises (44 FR 49963).’ “

Based on my firm's discussions, some franchisors that use brokers often disclose only the brokerage firm and not the brokers. Others are unaware that litigation and bankruptcies by brokers are required to be disclosed. Many franchisors are unaware of the requirement to include information about the brokers on their state cover pages and on the receipt to the UFOC, and several brokers are neither registered where appropriate nor have they registered a consent to service of process, where required.

The rationale for not abiding by the rule varies. Some franchisors believe that since the brokers do not hold face-to-face meetings and therefore are not required to provide prospects with a UFOC, they merely are providing leads and are not subject to disclosure. Others feel that including a long list of brokers in their UFOCs, especially when they may periodically change during the year, is a burden, and so listing only the brokerage firm should be sufficient. Still others are concerned that the change in the cadre of brokers might be considered a material change and thus might necessitate the suspension of franchise sales for a period of time in some states.

### **Conflicts of Interest**

The reason that disclosure and, where necessary, broker registration is required is to protect both the franchisor and franchisees. Regulatory burden aside, the rules regarding disclosure of brokers and whether these lead generation firms are brokers and subject to disclosure and, where required, registration are no longer subjects of significant debate.

Using brokers raises other issues clearly less rooted in the law but possibly more important, since they are based on integrity, ethical practices and fairness. The problem is how some brokers practice their craft.

It is important to point out that not all brokers practice their craft the same way, which highlights the fact that obfuscation is not an essential element of franchise sales. Each of the major broker networks, while disclosing that it is paid by the franchisor, in one form or another represents that it provides no-cost, beneficial services to prospective franchisees. On some of the web sites, though, a prospective franchisee is led to believe that the broker is its coach, adviser or consultant. Indeed, some brokers describe prospective franchisee as their clients, even though they are paid by, and are agents for, the franchisor. An assertion that the prospective franchisee is the client when the broker is a paid

agent of the franchisor is totally unsupportable. The conflict of interest and the unfairness to a potential franchisee are apparent.

Brokers' sites include promises to inexperienced prospective franchisees that their recommendations are unbiased and that their role is to help the prospect find the perfect franchise. Some claim that they are not trying to sell the prospect anything and that they have no reason to recommend any

particular franchise or a more expensive franchise. They include claims of doing the necessary research on the franchisor that minimize the prospective franchisee's risks.

Add to that the fact that many brokers are not disclosed in the franchisor's UFOC, might not be registered where required, may have a conflict of interest and may pressure the prospect to make a rapid decision, and the risk to prospective franchisees is clear.

Nowhere on any of the brokers' web sites is the prospective franchisee informed that the broker represents a limited number of franchisors or even which franchisors the brokers represent. While some brokers claim to have evaluated hundreds of franchisors, they do not disclose who their clients are, although the impression given is that the list is extensive and that only the best franchisors are selected. The perception created is that the brokers are selecting from hundreds of leading opportunities, when in fact their selection may be limited to only a handful of lesser opportunities.

The conflict of interest does not end there. None of the web sites that my firm reviewed disclosed that the commission and fees paid by franchisors on the sale of a franchise may not be uniform. The truth is that fees often vary, and, contrary to written assurances, brokers do have an interest in which franchise is selected by a prospect. A franchisor may be the "best fit" simply because the franchisor pays a higher commission or has a track record of closing franchise sales more quickly. If the "perfect" franchise pays a low fee but another client pays a substantial fee, it would need an Olympic leap of faith to believe that the prospect will be introduced to the franchisor paying the lower fee or no fee. It is important to remember that most of the largest and most attractive franchisors do not even use brokers.

### **Broker Claims**

On some sites, the prospective franchisee is taken back to a time when unsupportable claims about franchising's success were widely touted. Several brokers quote statistics on their web sites that have long been discredited, such as "[A]fter 10 years, franchises have a 90 percent survival rate. Compare that to just an 18 percent survival rate for other forms of independent businesses."

***“The rules regarding disclosure of brokers and whether these lead generation firms are brokers and subject to disclosure and, where required, registration are no longer subjects of significant debate.”***

Few franchisors today include these claims in their promotional literature. The reason is that the validity of the methodology used in reaching some of these statistics has long been under a cloud, and since there are no recent studies supporting those claims, they are questionable at best.

Brokers include claims on their web sites that they carefully select the franchisors to which they refer prospects, and some claim that those franchisors must meet the brokerages' exacting standards, including "return on investment, litigation, failures and other factors." However, these types of claims imply that these franchisors are the best of the best and that the prospective franchisee will have little financial risk. Indeed, one of the brokers promises to "minimize the risk." Some of the regulators and attorneys with whom my company has spoken felt that these claims, when taken together with information in the UFOC, might constitute an illegal earnings claim. For franchisors that use these brokers, this could be a problem.

Others felt that while an improper earnings claim was possible, it was more likely that the prospective franchisee had relied on an actionable promise made on behalf of the franchisor by its agent. This would be equally problematic to those franchisors.

Finally, of the major brokerage firms, one is a franchisor, while the others are not. However, there is a question concerning the impact on a franchisor should its broker be an inadvertent franchisor and in violation of the rule.

### Recommendations

- What should a franchisor do when working with a broker? Here are my recommendations:
- Disclose the individual franchise brokers in Items 2, 3 and 4 of the UFOC, including all the required personal and historic information, as well as that required on the state cover page and receipt. The individual brokers can be listed in an addendum to the UFOC.
- Keep its legal counsel informed about changes in the broker network, as those changes, depending on their materiality, may require changes in the UFOC.
- Require the broker to notify it immediately of any changes to the broker's network or of any individual broker who would affect the franchisor or its disclosure requirement.

- Require that each franchise broker in the network complete a Uniform Salesperson Disclosure Form as required by state statutes and also complete a registration application, as well as a consent to service of process in the appropriate states. Further, the broker should provide copies of all the applications and approval documents to the franchisor.
- Require the brokerage firm to certify that it has conducted a thorough and independent due diligence on each broker in its network and has verified the information in the registration application. The brokerage network also should indemnify the franchisor if it is found that information that should have been disclosed in the franchisor's UFOC is not provided to the franchisor. Since brokers are agents for the franchisor, I strongly recommend that franchisors require both the brokerage firm and the individual franchise brokers to indemnify them for their activities.
- Require brokers to obtain errors and omissions and broad liability insurance coverage from the broker, listing the franchisor as an additional insured.
- Require a broker to notify it immediately if there is any pending or threatened litigation or regulatory action taken against any of the broker's other clients (current and former) or any broker in the network (current and former) as it relates to the sale and offering of franchises.
- Provide to the broker network any standards it has set for conducting the sale of franchises, require the brokerage to abide by those standards and certify in writing prior to closing on a franchise sale that it has done so.
- Require the broker to provide it with a list of its other clients and update that list on a regular basis.

Requiring brokers to follow the existing rules and also providing additional disclosures and assurances to both franchisors and prospective franchisees are small prices for preserving the reputation that franchising has fought so hard to earn and keep. Insisting that future franchisees be treated fairly and also that trust, truth, honesty and integrity be required of outside sales agents is the only sensible course. ■

*Michael H. Seid is the managing director of Michael H. Seid & Associates, a franchise-consulting firm with offices in Connecticut and Michigan. Mr. Seid is co-author with the late Dave Thomas, founder of Wendy's, of "Franchising for Dummies" and is a member of the board of directors of the International Franchise Association.*