

103^D CONGRESS
1ST SESSION

H. R. 1315

To strengthen current Federal law and regulation to protect consumers in connection with the representation and sale of franchise businesses; to facilitate increased public disclosure regarding franchise opportunities, to enhance common law remedies for purchasers of franchises, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

MARCH 11, 1993

Mr. LAFALCE introduced the following bill; which was referred jointly to the Committees on Energy and Commerce and the Judiciary

A BILL

To strengthen current Federal law and regulation to protect consumers in connection with the representation and sale of franchise businesses; to facilitate increased public disclosure regarding franchise opportunities, to enhance common law remedies for purchasers of franchises, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Federal Franchise
5 Disclosure and Consumer Protection Act”.

1 **SEC. 2. FINDINGS AND PURPOSE.**

2 (a) The Congress makes the following findings:

3 (1) Franchise business relationships represent a
4 large and growing segment of the nation's retail and
5 service businesses and are replacing more traditional
6 forms of small business ownership in the American
7 economy.

8 (2) Because franchising remains a relatively
9 new form of business relationship, existing law has
10 not evolved sufficiently to protect prospective
11 franchisees adequately from misrepresentation in the
12 sale of franchise businesses or from fraudulent or in-
13 adequately structured franchise opportunities.

14 (3) Most prospective franchisees lack bargain-
15 ing power and generally invest substantial amounts
16 to obtain a franchise business when they are unfa-
17 miliar with operating a business, with the business
18 being franchised and with industry practices in fran-
19 chising.

20 (4) Franchisees may suffer substantial losses
21 when the franchisor, or the franchisor's representa-
22 tive, do not provide truthful or complete information
23 regarding the franchise opportunity, the prior busi-
24 ness experience of the franchisor or the details of
25 the franchisor-franchisee relationship.

1 (5) Traditional legal remedies have proven inad-
2 equate to protect the legitimate interests of pur-
3 chasers of franchises due to the failure of some
4 courts to recognize what inducements are material in
5 the sale of a franchise and what contractual provi-
6 sions are material in ongoing franchise relationships.

7 (b) It is the purpose of this Act to provide prospective
8 franchisees with additional information necessary to help
9 them make an informed decision about the purchase of
10 a franchise opportunity, to protect prospective franchisees
11 from fraudulent practices, to broaden the scope and en-
12 hance the availability and utility of common law remedies,
13 and to promote more equitable franchise relationships.

14 **SEC. 3. PROHIBITED ACTIONS.**

15 (a) In connection with the advertising, offering, li-
16 censing, contracting, sale or other promotion in or affect-
17 ing commerce of any franchise, or any relationship which
18 is represented either orally or in writing to be a franchise,
19 it shall be unlawful for any person, partnership or corpora-
20 tion—

21 (1) to employ a device, scheme, or artifice to
22 defraud;

23 (2) to engage in an act, practice, course of busi-
24 ness or pattern of conduct which operates or is in-

1 tended to operate as a fraud or deceit upon any per-
2 son;

3 (3) to obtain money or property, or assist oth-
4 ers to obtain money or property, by means of any
5 untrue statement of a material fact, any omission to
6 state a material fact, or any omission to state a ma-
7 terial fact necessary in order to make the statements
8 made, in the light of the circumstances under which
9 they are made, not misleading; or

10 (4) to discriminate among prospective
11 franchisees on the basis of race, sex, religion, dis-
12 ability or national origin—

13 (A) in the solicitation, offering or sale of
14 any franchise opportunity, except that, and
15 then only to the extent that, any discrimination
16 between franchisees is reasonable and is related
17 to a program under which franchises are made
18 available to a class of persons who may have
19 been denied franchise opportunities in the past
20 based on suspect classifications including race,
21 sex, religion, disability or national origin; or

22 (B) in the selection of any site or location
23 for a franchise business; or

24 (5) to represent or imply in any manner what-
25 soever that such franchise has been reviewed, en-

1 dorsed, recommended or approved by the United
2 States or any agency or officer thereof.

3 (b) In connection with any disclosure required by this
4 Act, or any disclosure document, notice or report required
5 by Federal law or regulation, it shall be unlawful for any
6 franchisor, subfranchisor or franchise broker, either di-
7 rectly or indirectly through any officer, employee, agent,
8 representative or attorney—

9 (1) to make or cause to be made an untrue
10 statement of material fact, omit to state a material
11 fact, or omit to state a material fact necessary in
12 order to make the statements made, in the light of
13 the circumstances under which they are made, not
14 misleading;

15 (2) to fail to furnish any prospective franchisee
16 with all information required to be disclosed by, and
17 at the time and in the manner required by the Fed-
18 eral Trade Commission (hereafter “the Commis-
19 sion”) in its Franchise Rule;

20 (3) to fail to furnish any prospective franchisee
21 with information which is current as of the close of
22 the franchisor’s most recent fiscal year, or within
23 ninety days thereof, or which reflects any material
24 changes since the close of such fiscal year;

1 (4) to fail to furnish any prospective franchisee
2 at the time disclosure is made copies of all collateral
3 documents, including manuals, memoranda, operat-
4 ing procedures and royalty schedules, where and to
5 the extent that such documents are incorporated by
6 reference into the franchise agreement, except that
7 a franchisor may require a confidentiality agreement
8 as a condition for reviewing confidential materials;
9 or

10 (5) to make any claim or representation to a
11 prospective franchisee, whether oral or in writing,
12 which is inconsistent with or contradicts any infor-
13 mation provided to the prospective franchisee in any
14 required disclosure.

15 (c) No provision of subsection (b) imposing any liabil-
16 ity shall apply to any action, statement or omission done
17 or made in good faith in conformity with any rule, regula-
18 tion or order of the Commission, notwithstanding that
19 such rule, regulation or order may, after such act or omis-
20 sion, be amended or rescinded by the Commission.

21 (d) For purposes of this section, an untrue statement
22 of material fact shall include any statement of fact which
23 has the intent or effect of misrepresenting the profitability
24 of a franchise opportunity, the rate of success of fran-

1 chises or franchisees associated with a franchise oppor-
2 tunity, or the rate of success of franchises generally.

3 **SEC. 4. MATERIAL OMISSIONS DEFINED.**

4 (a) It shall be an omission of material fact for a
5 franchisor, subfranchisor or franchise broker, either di-
6 rectly or indirectly through any officer, employee, agent,
7 representative or attorney, to fail to furnish any prospec-
8 tive franchisee with the following information at the time
9 and in the manner set forth by the Commission under the
10 Franchise Rule:

11 (1) The name and principal place of business of
12 the franchisor, its predecessor, parent firm, holding
13 company or other controlling entity of the
14 franchisor, if any, and the name under which the
15 franchisor is doing or intends to do business;

16 (2) A statement identifying—

17 (A) any parent or affiliate of the
18 franchisor or other related entity that is en-
19 gaged in franchising or providing services or as-
20 sistance to franchisees; and

21 (B) the name and position held of each of
22 the franchisor's current general partners or
23 principal officers (including the chief executive
24 and chief operating officer, financial, franchise
25 marketing, training and service officers), as ap-

1 plicable, other executives or subfranchisors who
2 will have management responsibility in connec-
3 tion with the operation of the franchisor's busi-
4 ness relating to the franchise business offered,
5 and all franchise brokers.

6 (3) A statement disclosing whether the
7 franchisor or any person identified in subsection
8 (2)—

9 (A) has, at any time during the previous
10 ten fiscal years, been convicted of a felony or
11 pleaded nolo contendere to a felony charge if
12 the felony involved fraud, embezzlement, fraud-
13 ulent conversion, misappropriation of property,
14 restraint of trade, violation of a Federal or
15 State tax law or violation of a State franchise
16 statute;

17 (B) has, at any time during the previous
18 ten years, been held liable in a civil action re-
19 sulting in a final judgment, or has settled out
20 of court any claim, including complaints, cross
21 claims, counterclaims, and third party com-
22 plaints, in a judicial proceeding and their
23 equivalents in an arbitration proceeding—

24 (i) involving allegations of fraud, em-
25 bezzlement, fraudulent conversion, mis-

1 appropriation of property, restraint of
2 trade or comparable allegations; or

3 (ii) involving a present or former
4 franchisee and which involved or involves
5 the franchisor-franchisee relationship; ex-
6 cept that such statement may omit ref-
7 erence to such actions which were dis-
8 missed by final judgment or settlement
9 without payment or liability by the
10 franchisor or entry of an adverse order
11 against the franchisor in which the
12 franchisor is bound to obligations which
13 are material either to the franchisor or
14 franchisee; and

15 (C) is subject to any currently effective
16 State or Federal agency or court injunctive or
17 restrictive order, has been subject to any such
18 order during the previous ten years, relating to
19 or affecting franchise activities or the
20 franchisor-franchisee relationship or involving
21 fraud, embezzlement, fraudulent conversion
22 misappropriation of property, restraint of trade
23 or violation of a Federal or State tax law.

24 Such statement shall set forth the identity and loca-
25 tion of the court or agency; a description of the na-

1 ture of the claim; the date of conviction, judgment
2 or decision; the penalty imposed or the damages as-
3 sessed; any payments made; the terms of settlement,
4 order or arbitrator's decision; and the date, nature
5 and issuer of each such order or ruling.

6 (4) A statement disclosing whether the
7 franchisor or any person identified in subsection (2)
8 is a party to any pending administrative, criminal or
9 material civil action or arbitration involving allega-
10 tions of fraud, embezzlement, fraudulent conversion,
11 misappropriation of property, restraint of trade or
12 comparable allegations, or complaints or counter-
13 claims involving franchise sales or the franchise rela-
14 tionship. Such statement shall set forth the identity
15 and location of the court or forum in which each ad-
16 ministrative action, civil action or arbitration is filed,
17 the date of such filing and a summary of the nature
18 of the allegations. For purposes of this subsection,
19 a civil action or arbitration is material if such action
20 or arbitration involves—

21 (A) a significant financial impact on a
22 franchisee or a former franchisee;

23 (B) any group of civil actions, irrespective
24 of the financial impact of any single action,
25 which in the aggregate have a significant im-

1 pact on the franchise system in seeking fifteen
2 percent or more of the current assets of the
3 franchisor or any affiliate of the franchisor;

4 (C) a current or former supplier or lessor
5 who supplied more than 5 percent of an item to
6 the franchise system; and

7 (D) claims or counterclaims which a rea-
8 sonable prospective franchisee would consider
9 important in making a decision regarding enter-
10 ing into a franchise relationship.

11 (5) A statement disclosing whether the
12 franchisor or any person identified in subsection (2)
13 have at any time during the previous seven fiscal
14 years filed in bankruptcy, been adjudged bankrupt,
15 been reorganized due to insolvency, or been a prin-
16 cipal, director, executive officer, or partner of any
17 other person that has so filed or was so adjudged or
18 reorganized, during or within one year after the pe-
19 riod that such person held such position in such
20 other person.

21 (6) A statement of the total funds which must
22 be paid by the franchisee to the franchisor or to any
23 person affiliated with the franchisor, or which the
24 franchisor or such affiliated person imposes or col-

1 lects in whole or in part on behalf of a third party.

2 Such statement shall include:

3 (A) a description of all funds which must
4 be paid—

5 (i) to obtain or commence the fran-
6 chise operation, including, but not limited
7 to, franchise fees, deposits, down pay-
8 ments, prepaid rent, and equipment and
9 inventory purchases, and

10 (ii) to carry on the franchise business,
11 including, but not limited to, royalty, lease,
12 advertising, training, insurance, sign rental
13 fees, and equipment or inventory pur-
14 chases;

15 (B) a description of any real estate, serv-
16 ices, supplies, products, inventories, signs, fix-
17 tures, or equipment relating to the establish-
18 ment or the operation of the franchise business
19 which the franchisee is directly or indirectly re-
20 quired by the franchisor to purchase, lease or
21 rent, and, if such purchases, leases or rental
22 are required from specific persons (including
23 the franchisor), the names and address of each
24 such person;

1 (C) a description of the basis for calculat-
2 ing, and actual amounts, where available, of
3 any revenue or other consideration to be re-
4 ceived by the franchisor, the franchisor's parent
5 firm, if any, or any person affiliated with the
6 franchisor, from each such person with whom
7 the franchisee is required to make such pur-
8 chases, leases or rentals; and

9 (D) an estimate of the total investment to
10 be paid by the franchisee, irrespective of the
11 type of expenditure and to whether payment is
12 made to the franchisor, to any person affiliated
13 with the franchisor, or to any third party—

14 (i) to obtain and commence operations
15 of the franchise business; and

16 (ii) to carry on the franchise business
17 during the initial twelve-month period fol-
18 lowing the opening of the franchise busi-
19 ness, including an estimate of loan repay-
20 ments, including interest, if part of the
21 franchisee's initial investment may be fi-
22 nanced.

23 (7) A statement describing the services and as-
24 sistance which the franchisor, persons affiliated with
25 the franchisor, or third parties designated by the

1 franchisor, are obligated to provide to the franchisee,
2 under the terms of the franchise agreement or any
3 agreement ancillary or collateral to a franchise:

4 (A) to obtain or commence the franchise
5 operation; and

6 (B) to carry on the franchise business.

7 Such statement shall include cautionary lan-
8 guage stating that the franchisor is not obli-
9 gated under the franchise agreement, or any
10 other agreement, to provide any additional serv-
11 ices or assistance to the franchisee other than
12 the services disclosed.

13 (8) A statement describing the trade names,
14 trademarks, service marks, logotypes, advertising or
15 other commercial symbols (hereafter “trade names
16 and trademarks”) which are to be licensed to the
17 prospective franchisee, or which are owned or used
18 by the franchisor to identify the goods or services to
19 be offered, sold, or distributed by the prospective
20 franchisee. Such statement shall indicate whether—

21 (A) such trade names or trademarks have
22 been registered with the United States Patent
23 and Trademark Office, or registered with the
24 State in which the franchise business is located

1 or is to be located, and the date and number of
2 any such registrations;

3 (B) there are any material restrictions on
4 the franchisor's right to license or the
5 franchisee's right to use such trade names or
6 trademarks;

7 (C) there are any pending interference, op-
8 position or cancellation proceeding, or any
9 pending material litigation involving such trade
10 names or trademarks of relevance to the state
11 in which a franchise is located or will be lo-
12 cated; and

13 (D) the franchisor is obligated by the fran-
14 chise agreement to protect the franchisee's
15 right to use such trade names or trademarks
16 and to protect the franchisee against claims of
17 infringement or unfair competition with respect
18 to such trade names and trademarks.

19 (9) A statement disclosing whether, by the
20 terms of the franchise agreement, any agreement an-
21 cillary or corollary to the franchise, or any other de-
22 vice or practice—

23 (A) the franchisee is to be limited in any
24 manner—

1 (i) in the goods or services he or she
2 may offer for sale;

3 (ii) in the customers to whom he or
4 she may sell such goods or services; or

5 (iii) in the geographic areas in which
6 he or she may offer for sale or sell goods
7 or services;

8 (B) the franchisee is granted territorial
9 protection by the franchisor, by which, with re-
10 spect to such territory or area, the franchisor—

11 (i) will not establish another, or more
12 than a fixed number of, franchises or com-
13 pany-owned outlets either operating under,
14 or selling, offering, or distributing goods or
15 services, identified by any trade name or
16 trademark set forth in subsection (8) of
17 this section;

18 (ii) will not establish other franchises
19 or company-owned outlets selling or leasing
20 the same or similar products or services
21 under a different trade name or trade-
22 mark; or

23 (iii) will not otherwise market the
24 same or similar products or services under

1 the same, similar or different trade name
2 or trademark; and

3 (C) the franchisor is marketing, intends to
4 market, reserves the right to market, or is con-
5 tractually precluded from marketing, through
6 arrangements other than a franchise or a com-
7 pany-owned outlet, the same or similar products
8 or services to be offered for sale by the
9 franchisee, whether under the trade name or
10 trademark set forth in subsection (8) or a dif-
11 ferent trademark or trade name, in the pro-
12 tected territory granted to the franchisee or, if
13 no such territory is granted, within a market
14 area defined as the larger of—

15 (i) the area in which the franchise is
16 expected to draw 80 percent of its busi-
17 ness, or

18 (ii) the area defined in the franchise
19 agreement for purposes of a
20 noncompetition covenant.

21 (10) A statement disclosing the existence of any
22 written agreement or commitment, or any public ex-
23 pression of intention, made by the franchisor, any
24 officer of the franchisor, or the franchisor's parent
25 firm or ultimate controlling person, if any, to dis-

1 pose of the corporation or partnership, or the major-
2 ity (controlling) interest of such corporation or part-
3 nership, which is identified in subsection (1) of this
4 section as the franchisor of the business being of-
5 fered for sale. Where an agreement or commitment
6 has been made, such statement shall include the
7 name and address of the person(s) or corporation
8 which has committed to purchase the franchisor
9 company or a majority interest in such company.

10 (11) A statement of a specific level, average or
11 range of sales, earnings, profit or loss for franchises
12 of the franchisor, which shall—

13 (A) have a factual basis in operating data
14 for sales, earnings, profits or losses from fran-
15 chise or nonfranchise outlets of the franchisor
16 and/or of its affiliates which offer for sale the
17 same or similar products and services, and
18 which are operated under the same trade name
19 or trademark as set forth in subsection (8), ex-
20 cept that—

21 (i) a franchisor which has offered/sold
22 franchises for less than two years, a
23 franchisor which has not more than ten
24 franchise and nonfranchise outlets, or no
25 more than five franchise outlets, to provide

1 a basis for such operating data, or an es-
2 tablished franchisor offering a new, sepa-
3 rate franchise concept, for which there are
4 no more than ten franchise or nonfranchise
5 outlets to provide a basis for such operat-
6 ing data, is not required to make such a
7 statement; and

8 (ii) a franchisor providing representa-
9 tions limited solely to the actual operating
10 results of a specific outlet offered for sale
11 is not required to make such a statement,
12 provided such representation is in writing,
13 is given only to potential purchasers of
14 such outlet, and is accompanied by the
15 names and last known addresses of each
16 owner of such outlet during the previous
17 five years;

18 (B) be derived from the most current in-
19 formation available to the franchisor, and/or to
20 its affiliates, pertaining to—

21 (i) gross sales of franchise and
22 nonfranchise outlets;

23 (ii) operating costs of franchise and
24 nonfranchise outlets, to the extent that
25 such costs are known to the franchisor,

1 can be estimated reasonably by the
2 franchisor or are discoverable by the
3 franchisor through exercise of reasonable
4 diligence, provided that where information
5 on operating costs of nonfranchise outlets
6 is used, appropriate adjustment shall be
7 made to reflect additional costs that will be
8 incurred by franchisees, to the extent that
9 such additional costs are known; and

10 (iii) the net profit or net loss of fran-
11 chises and nonfranchise outlets. At mini-
12 mum, a franchisor may identify the fiscal
13 year of such data and whether, on average,
14 a profit or loss occurred for franchise and
15 nonfranchised outlets, where such informa-
16 tion is known to the franchisor, can rea-
17 sonably be estimated by the franchisor or
18 is discoverable by the franchisor through
19 exercise of reasonable diligence; except that
20 the franchisor must include a statement
21 describing net losses or average net losses
22 of franchise and nonfranchised outlets
23 where the franchisor knows or should know
24 that such losses have occurred.

1 Where information relating to costs and net
2 profit or loss are not known to the franchisor
3 or can not be estimated or discovered through
4 reasonable diligence, the franchisor shall include
5 a conspicuous statement that such information
6 cannot be provided to prospective franchisees
7 and shall describe in detail the information that
8 is not disclosed, the reasons why such informa-
9 tion is not known or can not be obtained by the
10 franchisor, and the actions or procedures un-
11 dertaken by the franchisor, where applicable, to
12 obtain such information;

13 (C) have a reasonable basis for all claims
14 or representations, for which the burden shall
15 be upon the franchisor to show that it had a
16 reasonable basis at the time such representa-
17 tions were made;

18 (D) be included in full in the written dis-
19 closure document which is provided by the
20 franchisor to the prospective franchisee at the
21 time of making disclosure. A franchisor shall
22 make no additional information or representa-
23 tions regarding actual or potential sales, costs,
24 income or profits available to the potential
25 franchisee, or to any agent, attorney or lender

1 of the prospective franchisee, other than that
2 contained in such statement or elsewhere in the
3 disclosure document, except that a supple-
4 mental statement of actual operating results re-
5 lating to a specific outlet, or a statement di-
6 rected to the particular circumstances of a spe-
7 cific location may be made available to a pro-
8 spective franchisee interested in such outlet or
9 location, provided any supplemental statement
10 be made in writing and explain any departure
11 from the statement provided in the disclosure
12 document and the reasons for such departure;

13 (E) include a concise description of the
14 factual basis and the material assumptions un-
15 derlying its preparation and presentation. Such
16 description shall include a statement of whether
17 the representations made are based on operat-
18 ing data of franchised or nonfranchised outlets
19 of the franchisor, the number of such outlets
20 constituting the basis for such data, and the
21 number and percentage of franchised outlets of
22 the franchisor in operation during the period
23 covered by such representation that are known
24 to have attained or surpassed the results stated;

1 (F) be updated at least annually by the
2 franchisor and amended as necessary to reflect
3 changed material facts or to incorporate
4 changes which the franchisor knows, or should
5 have known, make such statement no longer ac-
6 curate or reflective of the operating experience
7 of franchised units; and

8 (G) include a statement that substan-
9 tiation of the data used in preparing the state-
10 ment shall be made available to the prospective
11 franchisee upon request.

12 (12) A statement disclosing, with respect to the
13 franchisor and as to the particular named business
14 being offered:

15 (A) the names, addresses, and telephone
16 numbers of—

17 (i) all franchisees in the State in
18 which the proposed franchise is to be lo-
19 cated, provided that there are at least
20 twenty-five such franchisees;

21 (ii) all franchisees in the State in
22 which the proposed franchise is to be lo-
23 cated and all franchisees in States geo-
24 graphically contiguous to such State, pro-

1 vided that there are at least twenty-five
2 franchisees in such States; or

3 (iii) all franchisees of the franchisor.

4 Where the number of franchisees to be disclosed
5 under this subparagraph exceeds fifty, such list-
6 ing may be in a separate document presented to
7 the franchisee with the disclosure document,
8 provided that the existence of such separate
9 document is disclosed in the disclosure docu-
10 ment.

11 (B) the number of franchisees with outlets
12 in the following categories that, within the
13 three-year period immediately before the close
14 of the franchisor's most recent fiscal year,
15 have—

16 (i) been canceled or terminated by the
17 franchisor;

18 (ii) not been renewed by the
19 franchisor;

20 (iii) been reacquired through purchase
21 by the franchisor;

22 (iv) been otherwise reacquired by the
23 franchisor; and

1 (v) left the franchise system or ceased
2 to do business under the franchise agree-
3 ment;

4 (C) the name, last known address and tele-
5 phone number and location of franchise(s) of
6 every franchisee who voluntarily or involuntarily
7 left the franchise system or ceased doing busi-
8 ness under the franchise agreement during the
9 five-year period immediately before the close of
10 the franchisor's most recent fiscal year.
11 Franchisors subject to the requirements of this
12 section upon the effective date of this Act, and
13 franchisors which shall commence franchising
14 after such date, may make disclosure pursuant
15 to this paragraph for the franchisor's most re-
16 cent fiscal year only, or for the franchisor's first
17 complete fiscal year only, and shall make appro-
18 priate disclosure following each succeeding fis-
19 cal year so that, after the close of the
20 franchisor's fourth fiscal year following such
21 date of enactment, or after the close of a
22 franchisor's fifth fiscal year of operation, disclo-
23 sure shall be provided for not less than five
24 years thereafter;

1 (D) the number of all previous owners of
2 a specific franchise outlet to be resold, or the
3 number of previous owners of franchise busi-
4 nesses or outlets of the same franchise system
5 who conducted business during the previous
6 seven years in the protected market area to be
7 granted to a franchise, or within the same mar-
8 ket area in which a franchise business is to be
9 located. The franchisor shall—

10 (i) provide such number in a supple-
11 mental written statement to potential pur-
12 chasers of such outlet, or to potential pur-
13 chasers of franchises in such market area;

14 (ii) maintain updated listings of all
15 such previous owners, which shall include
16 the name, last known addresses, business
17 locations, dates of ownership and reasons
18 for terminating the franchise relationship
19 for each owner; and

20 (iii) disclose that such listing shall be
21 made available to prospective franchisees
22 upon request; and

23 (E) the identity of any association, associa-
24 tions, advisory councils or other organizations
25 of franchise owners of the business being of-

1 ferred that are organized to promote the inter-
2 ests of franchises in their relationship with the
3 franchisor, and the name, current address and
4 telephone number of any officer or designated
5 contact person for such association, associa-
6 tions, advisory council or other organizations
7 from whom a prospective franchisee may seek
8 additional information. The franchisor shall
9 identify all such organizations affiliated with, or
10 recognized by the franchisor and independent
11 associations or organizations not affiliated with,
12 or directed in any manner by the franchisor,
13 and shall indicate for each such association or
14 organization whether it is affiliated with, or
15 independent of the franchisor, except that, the
16 franchisor shall identify only organizations
17 which have identified themselves to the
18 franchisor and which—

19 (i) have been in operation not less
20 than one hundred eighty days prior to the
21 time disclosure is made; and

22 (ii) represent not less than the lesser
23 of either fifty franchisees, or 25 percent of
24 the franchise outlets of the franchise
25 system.

1 (13) A balance sheet for the franchisor for the
2 most recent fiscal year, and an income statement
3 and statement of changes in financial position for
4 the franchisor for the most recent three fiscal years,
5 which shall:

6 (A) have been examined in accordance with
7 generally accepted auditing standards by an
8 independent certified or licensed public account-
9 ant, except that, unaudited statements may be
10 used only to the extent that audited statements
11 cannot be prepared under generally accepted
12 auditing standards, are prepared by an inde-
13 pendent certified or licensed public accountant,
14 and are accompanied by a clear and conspicu-
15 ous disclosure that they are unaudited; and

16 (B) include a separate, concise and con-
17 spicuous summary, prepared by an independent
18 certified or licensed public accountant, of the
19 sources of revenues of the franchisor for each
20 the franchisor's most recent three fiscal years,
21 stated in terms of the percentage of total an-
22 nual revenues of such franchisor attributed to
23 each of the following categories or sources of
24 revenue—

25 (i) pre-opening fees;

1 (ii) royalty payments;

2 (iii) pre-opening purchases by
3 franchisees of equipment, inventory or sup-
4 plies;

5 (iv) net rental income from real estate
6 leases or rental of real estate, fixtures or
7 equipment;

8 (v) post-opening purchases by
9 franchisees of equipment, inventory of sup-
10 plies, including goods and services sold to
11 franchisees for resale and payments to the
12 franchisor by suppliers with whom
13 franchisees are required to purchase goods
14 or services;

15 (vi) nonfranchised or company-owned
16 outlets; and

17 (vii) sales of goods and services to the
18 public through means of distribution other
19 than franchise and nonfranchised outlets,
20 whether under the same, similar or dif-
21 ferent trade name or trademark.

22 A franchisor may substitute, in lieu of the bal-
23 ance sheet and income statements under sub-
24 paragraph (A), the consolidated financial state-
25 ments of the franchisor's parent company which

1 include the franchisor's financial results, pro-
2 vided such parent company guarantees the
3 franchisor's financial performance and, provided
4 further, that such financial statement shall in-
5 clude a separate summary of the revenue
6 sources of the franchisor pursuant to subpara-
7 graph (B).

8 (b) Standards of material omissions set forth in sub-
9 section (a) are in addition to other facts, circumstances,
10 or sets of conditions which may be material under Federal
11 or State law or regulation.

12 (c) Each disclosure required in paragraphs (1)
13 through (13) of subsection (a) shall be commented upon
14 either positively or negatively in required disclosure docu-
15 ments by use of a clearly and concisely written statement
16 which fully incorporates all information required to be dis-
17 closed.

18 (d) Information required to be disclosed in supple-
19 mental statements in subsections (a)(11)(A)(ii) and
20 (a)(12)(D) of this section, and which relate to specific
21 franchise outlets or market areas offered for sale, shall
22 be presented to the prospective franchisee at the time of
23 making disclosure, as defined by the Commission in sub-
24 section 436.2(g) of the Franchise Rule.

1 (e) Information required to be presented to prospec-
2 tive franchisees upon request, pursuant to subsections
3 (a)(11)(F) and (a)(12)(C)(iii) of this section, where such
4 request is made in timely fashion, shall be made available
5 at the time the prospective franchisee is presented with
6 a copy of the franchisor's completed franchise and related
7 agreements to be executed by the parties, or not later than
8 five business days prior to the date that such agreements
9 are to be executed and the prospective franchisee is re-
10 quired to pay any consideration in connection with the sale
11 or proposed sale of the franchise.

12 (f) The franchisor shall exercise diligent efforts to
13 collect all relevant information relating to sales, costs and
14 operating profits and/or losses of franchise and/or
15 nonfranchise outlets from its own files and databases,
16 franchisees, subsidiaries, affiliates, employees, suppliers
17 and any other source from which such information is avail-
18 able to permit disclosure pursuant to subsection (a)(11)
19 of this section and to establish procedures for timely col-
20 lection of such information. The Commission shall set
21 forth in regulation the criteria with which it may consider
22 granting full or partial exemption from disclosure under
23 this subsection. Except where exempted under subsection
24 (a)(11)(A), or otherwise exempted by the Commission, a
25 franchisor shall be deemed to have made an omission of

1 material fact under this Act where disclosure pursuant to
2 subsection (a)(11) is not provided to prospective
3 franchisees, either in full or in part with appropriate ex-
4 planations relating to required disclosures under sub-
5 sections (a)(11)(B)(ii) and (a)(11)(B)(iii), within two hun-
6 dred and forty days following the date of enactment of
7 this section. Not later than ninety days after the end of
8 the franchisor's first complete fiscal year following the ef-
9 fective date of this Act, the franchisor, except as otherwise
10 exempted, shall comply fully with subsection (a)(11) and
11 shall be required to exercise reasonable diligence to obtain
12 and/or discover the information relating to sales, costs,
13 profits or losses of franchise and/or nonfranchise outlets
14 necessary to establish a reasonable basis for disclosure
15 under such subsection.

16 **SEC. 5. ACCOUNTS AND RECORDS.**

17 (a) It shall be unlawful for any franchisor or
18 subfranchisor, either directly or indirectly through any of-
19 ficer, employee, broker, agent or attorney, except as per-
20 mitted by rule, regulation or order of the Commission,
21 willfully to destroy, mutilate or alter any disclosure docu-
22 ment, account, book, record, receipt or other document re-
23 quired to be maintained and preserved pursuant to sub-
24 section (b) of this section.

1 (b) A franchisor, subfranchisor or franchise broker,
2 where applicable, shall maintain and preserve for such pe-
3 riod or periods as the Commission may prescribe by rule
4 or regulation, such disclosure documents, account, books,
5 records, receipts or other documents pertaining to any in-
6 formation required to be disclosed pursuant to section 4
7 of this Act, or which are necessary and appropriate to con-
8 stitute—

9 (1) the record of any transaction involving the
10 offering, negotiation, sale or resale of a franchise, or
11 of any relationship which is represented by the
12 franchisor to be a franchise; and

13 (2) the record forming the basis for any finan-
14 cial statement and any earnings representation re-
15 quired to be disclosed under section 4.

16 (c) The Commission shall set forth by regulation, as
17 appropriate, the manner in which all documents, accounts
18 and records are to be maintained and the period or periods
19 for which such documents, accounts and records are to
20 be preserved, except that no account, record or document
21 required to be maintained and preserved pursuant to this
22 section shall be preserved for a period of less than seven
23 years.

24 (d) All accounts, books, records and other documents
25 required to be maintained and preserved by any person

1 pursuant to subsection (b) shall be subject to examination
2 by the Commission, or any member or representative
3 thereof, either upon written request of the Commission or
4 upon subpoena as part of any enforcement action under-
5 taken by the Commission pursuant to section 6 of this
6 Act.

7 **SEC. 6. ENFORCEMENT.**

8 (a) Enforcement by Federal Trade Commission:

9 (1) The Commission is authorized and directed
10 to prevent any person from violating the provisions
11 of this Act in the same manner, by the same means,
12 and with the same jurisdiction, powers, and duties
13 as though all applicable terms and provisions of the
14 Federal Trade Commission Act (15 U.S.C. 41 et
15 seq.) were incorporated into and made a part of this
16 Act.

17 (2) Any person who violates the provisions of
18 this Act, or any rule of the Commission under this
19 Act, shall be subject to the penalties and entitled to
20 the privileges and immunities provided in the Fed-
21 eral Trade Commission Act in the same manner, by
22 the same means, and with the same jurisdiction,
23 power and duties as though all applicable terms and
24 provisions of the Federal Trade Commission Act
25 were incorporated into and made a part of this Act.

1 (3)(A) For purposes of section 3(b) of this Act,
2 the Commission shall have the authority to enforce
3 compliance with disclosure standards by means of
4 the disclosure statement required by the Commission
5 in its Franchise Rule or the Uniform Franchise Of-
6 fering Circular of the North American Securities Ad-
7 ministrators Association, Inc.

8 (B) Where the guidelines for preparation of the
9 Uniform Franchise Offering Circular are amended
10 by the North American Securities Administrators'
11 Association, or its successor, disclosures prepared in
12 compliance with the amended guidelines shall be pre-
13 sumed to comply with the requirements of the Com-
14 mission's Franchise Rule unless, within one hundred
15 and eighty days of formal notification of such
16 amendments by the North American Securities Ad-
17 ministrators' Association, or its successor, the Com-
18 mission responds in writing that it has determined
19 that the amended requirements do not provide equal
20 or greater protection to prospective franchisees than
21 the Commission's Franchise Rule.

22 (b) Civil actions by the Commission:

23 (1) Except as otherwise provided in subsection
24 (2), the Commission may commence a civil action in
25 a district court of the United States or in any court

1 of competent jurisdiction of a State to recover a civil
2 penalty or obtain appropriate relief against any per-
3 son, partnership, or corporation which violates any
4 provision of this Act, or any rule of the Commission
5 under this Act, in the same manner, by the same
6 means, and with the same jurisdiction, powers, and
7 duties as provided in sections 5(m), 13(b) and 19 of
8 the Federal Trade Commission Act (15 U.S.C.
9 45(m), 53(b) and 57b).

10 (2) Notwithstanding the three-year statute of
11 limitations provisions of section 19b of the Federal
12 Trade Commission Act (15 U.S.C. 57b(d)), any civil
13 action arising from a violation of this Act, or any
14 rule of the Commission under this Act, shall be
15 brought by the Commission before the later of—

16 (A) five years after the date on which such
17 violation occurred; or

18 (B) three years after the date on which the
19 violation was discovered or should have been
20 discovered through exercise of reasonable dili-
21 gence.

22 (c) The powers, duties, remedies and procedures set
23 forth in this section shall be in addition to, and not in
24 limitation of, any other powers, duties, remedies and pro-

1 cedures otherwise provided the Commission by the Federal
2 Trade Commission Act and other laws.

3 (d) The Commission is authorized to make such rules
4 and regulations as are necessary and appropriate to imple-
5 ment the provisions of this Act.

6 **SEC. 7. ACTIONS BY PRIVATE PERSONS.**

7 (a)(1) Any person injured by a violation of any provi-
8 sion of this Act, or any rule or order of the Commission
9 under this Act, shall have a right of action for all damages
10 caused by the violation, including costs of litigation and
11 reasonable attorney's fees, against any person found to be
12 liable for such violation.

13 (2) An action may be brought, without regard to the
14 amount in controversy, in any United States district court
15 or in any other court of competent jurisdiction before the
16 later of—

17 (A) five years after the date on which the viola-
18 tion occurred; or

19 (B) three years after the date on which the vio-
20 lation was discovered or should have been discovered
21 through exercise of reasonable diligence.

22 (3) Nothing in this Act or the Federal Trade Com-
23 mission Act shall be construed as creating any obligation
24 on the part of any injured person to seek relief from the
25 Commission prior to bringing an action under this section.

1 (b) Any person injured by a violation of this Act, or
2 threatened with injury by an impending violation of this
3 Act, may bring an action in a United States district court
4 to obtain a declaratory judgment that an act, omission or
5 conduct constitutes or would constitute a violation of this
6 Act and to enjoin a person who has violated, is violating,
7 or who is otherwise likely to violate any provision of this
8 Act. In such actions, the court may issue a temporary re-
9 straining order or preliminary injunction to protect the
10 public interest by halting a recurring or likely violation
11 of this Act, prior to a final determination on the merits,
12 in conformity with the principles governing the granting
13 of preliminary relief in other civil actions, except that no
14 showing of special or irreparable damage to such person
15 shall have to be made.

16 (c) In any action brought under subsections (a) or
17 (b) of this section, a court shall have the power to inter-
18 pret any benefit conferred, duty imposed, or restriction ap-
19 plied in favor of or against any party to a franchise agree-
20 ment as reciprocal and equally applicable to the other
21 party to the agreement and to provide an identical or simi-
22 lar benefit, impose an identical or similar duty, or apply
23 an identical or similar restriction on such other party, pro-
24 vided that such reciprocal application is consistent with

1 the laws of the State in which the franchise business is
2 located.

3 (d)(1) Except as otherwise provided in paragraph (2)
4 of this subsection, nothing contained in this Act shall limit
5 the right of a franchisor and a franchisee to agree to arbi-
6 tration, mediation, or other nonjudicial resolution of a dis-
7 pute, either in advance or after a dispute arises, provided
8 that the standards and protections applied in any binding
9 nonjudicial procedure agreed to by the parties are not less
10 than the requirements set forth in this Act; and

11 (2) Any stipulation or provision of a franchise agree-
12 ment requiring use of arbitration to resolve disputes aris-
13 ing under the agreement shall not apply to bar any action
14 brought in a United States district court or in any other
15 court of competent jurisdiction pursuant to this section
16 involving a request for damages and/or equitable relief
17 caused by a violation of section 3 of this Act.

18 (e) The private rights provided in this section are in
19 addition to, and not in lieu of other rights or remedies
20 created by Federal or State law or regulation.

21 **SEC. 8. PROHIBITION ON WAIVER OF RIGHTS AND LIABIL-**
22 **ITY.**

23 (a) It shall be unlawful for any franchisor or
24 subfranchisor, either directly or indirectly through any of-
25 ficer employee, agent, representative or attorney to—

1 (1) Require any term or condition in a fran-
2 chise agreement, or in any agreement ancillary or
3 collateral to a franchise, which directly or indirectly
4 violates any provision of this Act, and rule of the
5 Commission under this Act, or any provision of the
6 Franchise Rule; or

7 (2) Require a franchise to assent to any dis-
8 claimer, waiver, release or other provision of a fran-
9 chise agreement, or in any document relating to the
10 sale of a franchise, which would purport—

11 (A) to relieve any person from a duty im-
12 posed by this Act, any rule of the Commission
13 under this Act, or any provision of the Fran-
14 chise Rule; or

15 (B) to protect any person against any li-
16 ability to which he would otherwise be subject
17 under the Act, or any rule of the Commission
18 under the Act, either by reason of willful mis-
19 feasance, bad faith, or gross negligence in the
20 performance of disclosure and other duties, or
21 by reason of reckless disregard of obligation
22 and duties under the franchise agreement.

23 (b) Any condition, stipulation, provision, or term of
24 any franchise agreement, or any agreement ancillary or
25 collateral to a franchise, which would purport to waive or

1 restrict any right granted under this Act shall be void and
2 unenforceable.

3 (c) No stipulation or provision of a franchise agree-
4 ment or of an agreement ancillary or collateral to a fran-
5 chise shall—

6 (1) deprive a franchise of the application and
7 benefits of this Act or of a law of the State in which
8 the franchisee's principal place of business is located
9 by purporting to designate the law of another juris-
10 diction as governing or interpreting the franchise or
11 disclosure relating to such franchise;

12 (2) deprive a franchisee of the right to com-
13 mence an action against the franchisor for violation
14 of this Act, any rule of the Commission under this
15 Act, in a court or forum in the state of the
16 franchisee's principal place of business; and

17 (3) exclude collective action by franchisees to
18 settle like disputes arising from violations of this
19 Act, or any rule of the Commission under this Act.

20 (d) Compliance with this Act is not waived, excused
21 or avoided, and evidence of a violation of this Act or of
22 any rule of the Commission under this Act shall not be
23 excluded, by virtue of an integration clause, any provision
24 of a franchise agreement or an agreement ancillary or col-
25 lateral to a franchise, the parol evidence rule, or any other

1 rule of evidence purporting to exclude consideration of
2 matters outside the franchise agreement.

3 (e) The requirements of this section shall apply to
4 franchise agreements entered into, amended or renewed
5 on or after the date of enactment of this Act.

6 **SEC. 9. EFFECT ON STATE LAW.**

7 (a) This Act preempts State law only to the extent
8 that State law is inconsistent with any provision of this
9 Act, in terms of providing less protection to prospective
10 franchisees than provided by this Act, and then only to
11 the extent of such inconsistency.

12 (b) Nothing in this Act shall—

13 (1) alter or relieve any franchisor or other per-
14 son subject to the provisions of this Act from the ob-
15 ligation to comply with the laws of any State with
16 respect to franchise disclosure and registration, ex-
17 cept to the extent that such laws are inconsistent
18 with any provision of this Act; and

19 (2) preclude a State from enacting any law or
20 regulation that affords a greater level or broader
21 range of protections to franchisees and prospective
22 franchisees.

23 **SEC. 10. STUDY OF NEED FOR ADDITIONAL PROTECTIONS.**

24 (a) The Commission shall conduct an ongoing study
25 of the need to develop and implement additional provisions

1 to prevent evasions or violations of the requirements of
2 this Act or to strengthen disclosure of pertinent informa-
3 tion to prospective franchisees. In examining such addi-
4 tional provisions, the Commission shall consider the extent
5 to which such additional provisions may be implemented
6 under the Commission’s rulemaking authority.

7 (b) The Commission shall submit to the Congress,
8 not later than eighteen months after the date of enactment
9 of this Act, a report reviewing the implementation of this
10 Act, which shall include the results of the study required
11 by subsection (a). The Commission shall submit such addi-
12 tional reports to the Congress as are merited by later find-
13 ings of such study.

14 **SEC. 11. EFFECTIVE DATE.**

15 Except as otherwise provided, the provisions of this
16 Act shall take effect one hundred and eighty days after
17 the date of enactment of this Act.

18 **SEC. 12. DEFINITIONS.**

19 For purposes of this Act—

20 (1) the term “affiliate” means a person control-
21 ling, controlled by, or under common control with a
22 franchisor;

23 (2) the term “advertisement” means a commu-
24 nication circulated generally by mail, or print media
25 or electronic media, or otherwise disseminated gen-

1 erally to the public, in connection with an offer or
2 sale of a franchise;

3 (3) the term “commerce” has the same mean-
4 ing as in section 4 of the Federal Trade Commission
5 Act (15 U.S.C. 44);

6 (4) the term “Commission” means the Federal
7 Trade Commission; and

8 (5) the term “disclosure document” means ei-
9 ther the disclosure statement required by the Com-
10 mission in Trade Regulation Rule 436 (16 CFR s
11 436) as it may be amended, or an offering circular
12 prepared in accordance with Uniform Franchise Of-
13 fering Circular guidelines as adopted and amended
14 by the North American Securities Administrators
15 Association, Inc., or its successor.

16 (6) The term “franchise” means—

17 (A) any continuing commercial relationship
18 created by a contract or agreement, whether ex-
19 press or implied, oral or written, where—

20 (i) one person (the franchisor) grants
21 to another person (the franchisee) the
22 right to engage in the business of offering,
23 selling or distributing goods or services, in
24 which—

1 (I) the goods or services offered,
2 sold or distributed by the franchisee
3 are substantially associated with the
4 trademark, service mark, trade name,
5 logotype, advertising, or other com-
6 mercial symbol owned or used by the
7 franchisor; or

8 (II) the franchisee must conform
9 to quality standards established by
10 the franchisor for the goods or serv-
11 ices to be offered, sold or distributed,
12 and operate under a name that in-
13 cludes, in whole or in part, the
14 franchisor's trademark, service mark,
15 trade name, logotype, advertising, or
16 other commercial symbol;

17 (ii) the franchisor—

18 (I) communicates to the
19 franchisee knowledge, experience, ex-
20 pertise, know-how, trade secrets or
21 other nonpatented information, re-
22 gardless of whether it is proprietary
23 or confidential;

1 (II) provides significant assist-
2 ance in the franchisee's method of op-
3 eration; or

4 (III) exercises significant controls
5 over the franchisee's method of oper-
6 ation of the business; and

7 (iii) the franchisee, as a condition for
8 obtaining or commencing operation of a
9 franchise, is required to make, or to com-
10 mit to make, payment or other consider-
11 ation to the franchisor, or an affiliate of
12 the franchisor, other than payment for
13 commercially reasonable quantities of
14 goods for resale at a bona fide wholesale
15 price.

16 (B) a subfranchise; or

17 (C) any commercial relationship entered
18 into in reasonable reliance on representations,
19 whether oral or written, that the criteria of sub-
20 section (A) will be met.

21 (7) The term "franchise broker" means a per-
22 son, other than a franchisor or franchisee, who sells,
23 offers for sale or arranges for the sale of a fran-
24 chise.

1 (8) The term “franchisee” means a person to
2 whom a franchise is granted.

3 (9) The term “Franchise Rule” means Trade
4 Regulation Rule 436 (16 CFR 436) as promulgated
5 and amended by the Federal Trade Commission.

6 (10) The term “franchisor” means a person
7 who grants a franchise or a subfranchise.

8 (11) The terms “material” and “material fact”
9 includes—

10 (A) any fact, circumstance, or set of condi-
11 tions which a reasonable franchisee or a reason-
12 able prospective franchisee would consider im-
13 portant in making a significant decision relat-
14 ing to entering into, remaining in, or abandon-
15 ing a franchise relationship; and

16 (B) any fact, circumstance, or set of condi-
17 tions which has, or may have, any significant fi-
18 nancial impact on a franchisor, franchisee or a
19 prospective franchisee.

20 (12) The term “offer” or “offering” means any
21 effort to offer or to dispose of, or solicitation of an
22 offer to buy, a franchise or interest in a franchise
23 for value.

1 (13) The term “outlet” means a place of busi-
2 ness, temporary or permanent, fixed or mobile, from
3 which products or services are offered for sale.

4 (14) The term “person” means a natural per-
5 son or any legal entity recognized in law.

6 (15) The term “State” means a State, the Dis-
7 trict of Columbia, and any territory or possession of
8 the United States.

9 (16) The term “subfranchise” means a contract
10 or an agreement by which a person pays a
11 franchisor for the right to sell, offer for sale or ar-
12 range the sale of franchises, or to provide goods or
13 services to franchisees.

14 (17) The term “subfranchisor” means a person
15 who is granted a subfranchise.

○

HR 1315 IH—2

HR 1315 IH—3

HR 1315 IH—4