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LAW JOURNAL NEWSLETTERS

LJN'S
FRANCHISING
BUSINESS & LAW ALERT®

Volume 13, Number 7 • April 2007

e-Disclosure After the FTC Rule Amendments

By Lee Plave

Whatever qualms there may have been about e-disclosure should, with the release of the FTC's amended Franchise Rule, be resolved. Let the record be clear: The Federal Trade Commission ("FTC") has removed all doubt with respect to e-disclosure — it is now officially sanctioned. Whatever concern there may have been, at this stage, is a matter of history.

In its Statement of Basis and Purpose, published with the newly amended Franchise Rule, the FTC spoke plainly on the topic:

> [T]he final amended Rule also promotes efficiency and reduces compliance costs by enabling franchisors to use their own judgment in deciding how to disseminate disclosure documents. For example, part 436 permits franchisors to furnish disclosures electronically through a variety of media, including CD-ROM, Internet website, and email.

(FTC Statement of Basis and Purpose, at 22 (Jan. 23, 2007). This document has not yet been published in the Federal Register, but it is available at *www.ftc.gov/opa/2007/01/franchiserule.htm*.)

Thus, the FTC made clear, once and for all, that e-disclosure is permitted — at least once the new Rule takes effect. The rules for providing e-disclosure are not all that difficult, and an analysis of this area involves looking at more than just the FTC Rule.

In the Statement of Basis and Purpose, the FTC did not explicitly address the question of when franchisors may start to provide e-disclosure. It is anticipated that the FTC will address this point when it issues its compliance guidelines. While many if not most provisions of the amended Rule take effect on July 1, 2007 or later (but by July 1, 2008), as of when the franchisor complies with the new disclosure guidelines, some have raised questions about "organic" provisions such as those relating to e-disclosure, and whether they take effect on July 1, 2007. In the "FAQs" posted on the Commission's Web site, the FTC's staff noted that they will consider other policy issues, such as the FTC's emphasis on allowing e-disclosure and the impact of E-SIGN. These factors tend to suggest that the Commission will formally allow e-disclosure on July 1, 2007. Of course, some commentators have concluded that

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Parent Disclosure Under the Amended FTC Rule

The Parent Exposed

By John R. F. Baer

In the October/November 2004 Special Issue of *FBLA*, we speculated that if there was one group that may be unhappy about the Federal Trade Commission ("FTC") Staff Report's proposed revisions to the FTC Franchise Rule, it had to be the parents of franchisors (or maybe franchisors who have parents). Now that the FTC has released the final amended FTC Franchise Rule, we know that a parent's disclosure burden will be increased. One provision may have a profound effect on how certain franchise companies do business. Because there are some ambiguities in what is being required, it may be prudent for the FTC to clarify its intention in the Guidelines it plans to issue.

While the existing FTC Franchise Rule currently requires disclosure of certain information about a parent, most franchisors currently comply with the UFOC Guidelines, which do not directly reference the parent (although the Item 21 Instructions say that a company owning 80% or more of a franchisor may be required to include its financial statements). The final amended FTC Franchise Rule directly addresses parent disclosure and adds this definition: "*Parent* means an

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since E-SIGN took effect in 2000, e-disclosure is permitted in any case.

BACKGROUND

On June 30, 2000, President Clinton signed into law the Millennium Digital Commerce Act, also known as the E-SIGN Act (or, simply, as "E-SIGN"), which pre-empted almost all state and federal laws and regulations that limited use of electronic signatures, agreements, or records (Pub. L. No. 106-229, 114 Stat. 464 (2000), codified at 15 U.S.C. §7001 et seq.). Although the E-SIGN Act does not mandate that contracts and disclosures be provided electronically, it eliminates the barriers to doing so (15 U.S.C. §7001). In a memorandum to agencies of the Executive Branch of the U.S. Government, the Director of the Office of Management and Budget ("OMB") explained the new law and provided OMB's guidance on complying with its requirements. The Director wrote that:

> Many Federal, State, and local laws or rules require that parties receive notices and disclosures in connection with private transactions (for example real estate purchases and settlements). To the extent these laws or rules require paper notices, E-SIGN largely supersedes them. (Jacob Lew, "Memorandum for the Heads of Departments and Agencies," Office of Management and Budget, Sept. 25, 2000, available at *www.whitehouse.gov/omb/memoranda/m00-15.html*.)

Special requirements pertain to "consumer" disclosures under E-SIGN. Thus arises the inevitable question as to whether the "consumer" provisions of E-SIGN apply to franchise transactions. Fortunately, the Act contains a definition that resolves the question. Under the Act, franchise transactions are not deemed consumer transactions, because the Act defines the term "consumer" in its ordinary meaning: "an individual who obtains, through a transaction, products or services which are used primarily for personal, family, or household purposes." 15 U.S.C. §7006(1). (*See also* Staff Report, *infra* note 6, at 195.)

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THE CURRENT LANDSCAPE

The FTC Staff recognized E-SIGN's impact on e-disclosure when it issued its August 2004 "Staff Report to the Federal Trade Commission." That document, issued online, is available at the FTC's Web site, at *www.ftc.gov/bcp/menu-fran.htm* (the "Staff Report").

Among other things, the staff reflected upon the earlier Notice of Proposed Rulemaking ("NPR"), as that iteration of the proposed amendments initially included provisions specifically regulating e-disclosure. Instead, the 2004 Staff Report concluded that "[i]n light of E-SIGN, the staff has reconsidered the NPR proposals. As explained below, we recommend that the Commission eliminate the NPR's proposed electronic disclosure instructions (NPR section 436.7). In lieu of specific electronic disclosure instructions, we recommend that the Commission broaden the proposed revised Rule's general instructions (NPR section 436.6) to cover the furnishing of all disclosure documents, paper and electronic alike." (*See* Staff Report at 210.)

In January 2007, when it issued the amended Rule, the FTC followed its staff's advice. The amended FTC Franchise Rule confirms that there are no barriers to the provision of e-disclosure in the franchise context. While the FTC adopted provisions that relate to how disclosure can be provided — and while other commentators can debate whether even those limited provisions are permitted under E-SIGN — these portions of the amended Rule do not pose a significant practical barrier to e-disclosure.

HOW TO PROVIDE E-DISCLOSURE UNDER THE AMENDED RULE

The FTC intentionally adopted guidelines — rather than specific standards — for providing e-disclosure. In doing so, the Commission

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LJN's Franchising Business & Law Alert 023145
Periodicals Postage Paid at Philadelphia, PA
POSTMASTER: Send address changes to:
ALM
345 Park Avenue South, New York, NY 10160
Annual Subscription: $329

Published Monthly by:
Law Journal Newsletters
1617 JFK Boulevard, Suite 1750, Philadelphia, Pa 19103
www.ljnonline.com

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astutely recognized that new technologies will inevitably evolve and change how parties can — and prefer — to exchange documents such as an eUFOC. Moreover, as the general population of our country grows more comfortable with the electronic exchange of all kinds of information, over time, that comfort level will extend evenly, or perhaps even more so, into the ranks of people as innovative and entrepreneurial as prospective franchisees. Therefore, new electronic disclosure methods are to be expected, and fortunately, the amended Rule will not hem them in.

There are basically four standards for providing e-disclosure under the amended FTC Rule:

1) Pre-Disclosure Notification. The FTC Rule will require franchisors, before they furnish the disclosure document, to advise the prospect of several points: a) the formats in which the disclosure document is made available; b) any prerequisites for obtaining the disclosure document in a particular format; and c) any conditions necessary for reviewing the disclosure document in a particular format. (*See* new §436.6(g), at page 342 of the SBP; *see also* SBP at 205-06.)

In practical terms, since this needs to be done before the UFOC is provided, a good place to provide this information might be, as the FTC suggested, on the franchise application form (or online screen). An example of this disclosure might read: "We will send you our UFOC as an attachment to an e-mail. You will need to have a computer and an e-mail address that can receive an e-mail with a 3MB attachment. Receiving our UFOC may take long unless you have a broadband connection. You also need a copy of Adobe Reader, which you may already have on your computer, or which you can download for free at [URL]."

2) Delivery. Franchisors will need to prepare and deliver the eUFOC in one simple file, without any extraneous information, such as external hyperlinks. (*See* new §436.6(d), at page 341-42 of the SBP; *see also* SBP at 201-03.)

Internal navigation links (*e.g.,* a hotlink from the eUFOC's table of contents directly to the page on which Item 11 can be found) will, however, be permitted. In practical terms, the eUFOC should be prepared in a format such as "PDF" (portable document format) — so that the document can be read by the prospect in the same format as it was prepared by the franchisor, without regard to what kind of computer the prospect uses or what software was used to create the content. Delivery can be accomplished in any manner — such as by e-mail, downloading from a Web site (*e.g.,* one run by the franchisor or one operated by a commercial service), or in a physical medium (*e.g.,* on a CD or a thumb drive).

3) Proof. The franchisor must have proof of its delivery of the UFOC. The FTC has, wisely, left it up to the parties to determine what constitutes proof (*see* new §436.5(w), at page 340-41 of the SBP; *see also* SBP at 78 (n. 280) and 192-93):

> As an initial matter, franchisors always have the burden of proof to show that they have complied with the Rule's obligation to furnish disclosures. We also believe that the Rule should be as flexible as possible, allowing franchisors to keep records and to offer proof, in the format that is most convenient to them. (SBP at 78 (n. 280)

There are various methods of obtaining a receipt. One would be to ask the prospect to open the eUFOC, print out the last page (the receipt), sign and date the receipt, and send it back to the franchisor (perhaps by fax). Another might be a link to a plain-vanilla Web page with no information or outside links other than the text of an Item 23 receipt (for consumer education purposes) and spaces in which the recipient can provide information to confirm that she or he received the eUFOC on a particular date. Although this seemingly defies the no-external-hyperlinks rule noted above, that rule is intended to prevent introduction of extraneous information into the UFOC. A link to a page at which there is no information other than an electronic copy of the receipt page, and no link to the franchisor's Web page, is consistent with the regulatory goal of keeping out extraneous information and also with the Commission's goal of allowing parties to choose the most efficient way to provide disclosure. Just as importantly, E-SIGN specifically eliminated most all statutory and regulatory barriers to verifications and acknowledgements of receipt (*see* 15 U.S.C. §§101(c)((2)(B), 101(g)).

4) Record keeping. Franchisors must keep a copy of each materially different version of their UFOC, as well as a signed receipt for each completed franchise transaction, for three years. (*See* new §436.6(h) and (i), at page 342 of the SBP; *see also* SBP at 206-08.)

The Commission observed that many states impose similar (if not more stringent) requirements, and also that franchisors usually keep similar records as a matter of prudent business practice. Indeed, under NASAA's Model Rule, adopted in California and Indiana, the franchisor must be able to prove receipt or its original authority to send disclosure electronically is (in effect, retroactively) ineffective. (*See* Cal. Code Regs, tit. 10, §310.114.4(a)(3), available at Bus. Franchise Guide (CCH) 5050.24; Indiana Statement of Policy Regarding Electronic Delivery of Franchise Disclosure Documents, available at Bus. Franchise Guide (CCH) 5140.06.)

In sum, any questions as to whether franchisors may give disclosure electronically were settled by the E-SIGN Act and are unambiguously put to an end by the FTC's approach in the amended Franchise Rule. With that, franchise disclosure formally enters the digital age.

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Movers & Shakers

As of March 1, **Leonard Vines** and **Marilyn Nathanson** joined the firm of Greensfelder, Hemker & Gale, P.C. (St. Louis, MO). Greensfelder has an established franchise transaction and litigation practice, including **Eric Riess**, chair of the Corporate Department, and **Christopher Feldmeir, Dawn Johnson, David Harris, Kevin Hormuth, Sheldon Stock,** and **Jennifer Weber.**

"The firm is the fourth-largest in St. Louis, with 170 attorneys. Greensfelder represents franchisors, franchisees, and franchisee associations," said Vines. "We are planning to expand our national franchise transactional practice, while also building on the firm's strengths and resources in franchise litigation in Missouri, Illinois, and several other states."

After more than 10 years with DLA Piper LLP's Tampa, FL, office, **Scott Weber** recently joined the partners of Phelps Dunbar LLP (also in Tampa) to head the firm's franchise practice. **Alison R. Miller**, an associate, formerly of Haynes & Boone (Dallas), also recently joined Phelps Dunbar's franchising practice.

Weber and Miller will be working with **P. Regan Richard,** a partner in Phelps' Baton Rouge office, and **Andy Ezell** and **Randy Roussel**. The Baton Rouge office represents multi-unit Taco Bell, Popeyes, and Burger King franchisees, among others.

The hiring of Weber represents a significant additional commitment to the franchise industry for Phelps Dunbar. Weber brings to the firm considerable experience in representing startup and mature franchisors. However, the firm will work with both franchisors and franchisees (when conflicts do not arise). "I see a great potential for growth in Florida and the Gulf states," Weber told *FBLA*. "Phelps Dunbar is a well-respected regional firm that has offices throughout the Gulf, as well as in London."

As a midsize firm, Weber adds that Phelps Dunbar offers the ideal blend of cost-effective service and wide range of expertise. "Ancillary work for the firm may be significant. Already we are generating new tax and employment work, and I can see the franchisor and franchisee clients choosing us for a wider range of corporate, real estate, and trademark work, as well as litigation services," he said.

Three well-known franchise lawyers, **Lee Plave, David Koch,** and **John Tifford**, have formed Plave Koch PLC (Reston, VA). Koch had been a partner and chair of the Franchise Group at Washington, DC's Wiley Rein LLP, while Plave and Tifford were long-time partners in the Franchise and Distribution practice at DLA Piper.

Plave said the move was designed to "get us closer to our clients and give us more flexibility in how we deliver and charge for legal services." The three partners, collectively, have over 60 years of franchise law experience in private practice, and all are former Federal Trade Commission lawyers, a perspective that they have begun putting to use in helping clients transition to the newly amended FTC Franchise Rule.

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News Briefs

Popeyes Chicken Sues Church's Chicken for Poaching Franchises

In late February, AFC Enterprises Inc., the franchisor of Popeyes Chicken & Biscuits, filed a lawsuit against Church's Chicken, another fast-food chicken franchise that it owned until November 2004. In the lawsuit, AFC charged Church's and CVI Co. with violating CVI's franchise agreement with Popeyes by selling sites where CVI formerly operated Popeyes units. The lawsuit is seeking $20 million in damages.

A Church's representative told FBLA that Church's "considers the lawsuit without merit … and we will prevail in court, if it comes to that."

CVI is a former Popeyes franchisee that sold the sites for 10 Popeyes outlets in Texas to Church's last year. According to Church's, none of the sites were operating as Popeyes restaurants at the time of the sale. Since purchasing the sites, Church's has opened its brand at six of the sites.

Popeyes alleges that its franchise contract with CVI prohibits the franchisee from "selling the business to a competitor without AFC's written consent … or changing the restaurants' brands …"

AFC bought the Church's brand in 1992, but it decided to sell the brand in mid-2004 as part of a divestment of several franchises. Private equity firm Arcapita Inc. bought Church's, which joined its eclectic mix of businesses (medical, dental, insurance, log homes, aviation engines, and IT, to name a few), and real estate investments in the United States, Europe, and Bahrain. Arcapita is a subsidiary of the First Islamic Bank of Bahrain.

AFC Enterprises is represented by Pope, McGlamry, Kilpatrick, Morrison & Norwood, LLP.

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Court Watch

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brought in more than one locale, such as where the contract was entered into or where the breach occurred. Most franchise venue clauses select the home county of the franchisor, which is the likely place that the contract was made and breached. Nonetheless, in light of these decisions, franchise companies may want to revisit their "forum" selection clauses.

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