# Introduction

The purpose of this document is to help you better understand the Franchise Disclosure Document (FDD) and the Franchise Agreement. It’s important to completely understand what you are getting into, prior to signing a Franchise Agreement.

It will be most beneficial if you read the FDD from start to finish. Then go through each section and make notes of any questions you may have. Please indicate the section and page number of the items that need clarification. This will assist the Franchisor to quickly find the language you are referring to that needs further explanation.

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### What is the Franchise Disclosure Document?

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The Franchise Disclosure Document, or FDD, is a legal document that the Federal Trade Commission (FTC) requires franchisors to provide to franchise candidates. It must be received at least 14 days prior to us accepting any money or you signing a Deposit Agreement or Franchise Agreement. The FDD is intended to help candidates make an informed decision on whether to buy a particular franchise. Reading and understanding the documents is one part of the “Due Diligence" process, to help you make an informed decision on the business.

Each year Franchisors registers this document in each state where they intend to award franchises. Franchisors make changes and updates to the FDD and Franchise Agreement annually. While this looks like a long document, Franchisors typically will make every attempt to create documents that are easy to read and understandable. That does not mean you should not, or will not, have questions. People that have no questions are simply afraid to ask, or they have not fully read and comprehend the documents. We encourage you to ask questions to make sure you understand what it is saying.

I encourage you to have the documents reviewed by your franchise attorney. It is important to understand that franchising is a different business model and not all attorneys work in or have expertise in this area. Many parts of the FDD are included in a required format. It is important to understand, unlike other contracts, the franchise agreement is **not negotiated**. When the agreement is written, and registered with the states, the Franchisor are saying to the regulators this is what they will offer potential franchisees in your state. To change that offer, they must amend the agreement and make the same offer to all other candidates with that state.

### What is in the Franchise Disclosure Document?

The Federal Trade Commission requires all Franchisors to provide candidates with important information about the business and the offers being made to you. In addition, Franchisors are required to provide you information that includes: background on the franchise concept, costs of buying the franchise, audited financial statements from the prior 3-years, and details on your expectations and requirements, as well as the expectations and requirements of the Franchisor. The Table of Contents list of items in the FDD includes several exhibits that are made part of the document.

During your process of investigating the franchise one question that is of great importance to all candidates: What is the financial potential of the business? A Franchisor can only tell you exactly what they put in the *Item 19,* the Financial Disclosure. It might seem like a simple question with simple answers, however, it is not. It would be just like taking a group of 50 students on the first day of class and predicting what they will score on the final exam, with no past records on their prior schooling or test scores.

Franchisors would like to provide you with more information, but so much of the outcome depends on **you,** and your willingness to follow the plan.

### How Do I Get the FDD?

The process to obtain the FDD will vary with each franchise concept. Below is a typical process:

1. Visit with a development representative in their organization

2. Attend an informational webinar (s).

3. Complete and submit an application.

As soon as you complete and submit an application, they will send you the FDD via email. They will ask you to date and sign Item 23, which is the Receipt Page. **This does not obligate you to anything!** Item 23 simply documents when you received the FDD. This is important for the Franchisor so that they can document the day you were disclosed with the FDD. *They must wait a minimum of 14 days; from the time you sign and return the FDD Receipt prior to signing any additional documents.*

Also, during this period, you may be approved to speak to current franchise owners. This process allows you to further hear about the business directly from their experienced owners.

### How to Read the FDD

Once you have received the FDD via email plan to read it carefully and complete. It is loaded with important information; your job is to read and understand what it is saying. It is important to understand how much you are expected to invest. On the flip side, it is important to make sure this investment level works with your financial situation. Do you have access to the necessary upfront capital?

The FDD is divided into sections called Items, there are 23 Items and Exhibits. This document will guide you through a brief overview of each Item and Exhibits.

Item 1

### Franchisor, Parent and Affiliates

This is self-explanatory.

Item 2

### Business Experience

This section is to “meet their team.” You have already started working with some of them. Item 2 gives you background on some of the Home Office Staff.

Item 3

### Litigation

In Item 3, Franchisors are required to disclose all litigation they have been involved in during the past 5 years. It is always a good idea to ask questions about any litigation listed. Most Franchisors can explain what brought them to litigation and it can help you understand the process even more.

Item 4

### Bankruptcy

Bankruptcy can be an area like litigation. A Franchisor is required to report bankruptcies for the corporation as well as for any of the individuals listed in the FDD. This, in and of itself, might not be a problem. If the company went through a bankruptcy, you better be cautious. If one of the individuals went through a bankruptcy, a few questions should alleviate your concerns.

Item 5

### Initial Fees

The initial fee will be indicated and if they offer multiple territories that will be addressed as well.

Item 6

### Other Fees

**Royalties -** Item 6 provides an accounting of all fees that are ongoing. Royalties are typically based on gross revenue. Gross revenue is normally defined as the total amount of services offered.

**Software License** – Most Franchisor require you to use their specific software and there are costs associated for use of the software.

**Local marketing** - Is spent mostly on advertising. Most Franchisors require a minimum amount of money that they recommend you spend each month. As your business grows this should become a percentage of your sales each month, in order to keep your business growing.

**Transfer and renewal fees** only affect you when you sell/transfer your business to someone else or at the end of ten years you prepare to renew.

**Indemnification** simply means you must obtain and maintain at all times business liability insurance and the Franchisor must be listed as additionally insured.

**Meeting Attendance -** Each year most Franchisor offer a minimum of one national convention/reunion. Typically, you are required to attend or send a representative from your franchise to this meeting each year. Most Franchisor will require to pay for this convention/meeting whether or not you attend. This is a great opportunity for you to learn from the Franchisor and other Franchisees! I strongly encourage you to take advantage of these events.

**National Advertising Fund -** Most franchise systems have a set amount of money that is paid into a national advertising fund. These dollars are used to attract customers to their franchises.

Item 7

### Estimated Initial Investment

This itemizes the total projected or estimated expenses that you need to be prepared to spend to get your business operational. At the bottom of the chart they estimate total minimum and total maximum. As your business grows, some of these expenses will be paid out of the operation of the business, but you need to go into this aware that the amount your business can fund will depend on how quickly you get the business up and running. Some of these expenses are a repeat from Item 5. This is just to show the total estimated projection. The notes below the chart and the references in the Franchise Agreement provide further explanation for these expenses. Make sure you understand these items and feel free to ask questions as you work with the Franchisor through this process.

Item 8

### Restrictions on Sources of Products and Services

**Required purchases** means that you cannot buy products from anywhere you want. Typically, the Franchisor will have their specific list of vendors that you will be purchasing from. Normally, you must purchase your products only from their approved vendors.

**Revenue from franchise purchases.** This item is a required disclosure.

**Designated Suppliers** Franchisors may have different types of vendors or suppliers that you are required to use.

Item 9

### Franchisee Obligations

There are many requirements listed in this section, and each are discussed in detail in the *franchise agreement*. In column 2 it lists the location in the Franchise Agreement where each item is discussed and in column 3 the location in the *FDD*. To understand your obligations, you should read the obligation in Column 1 and then read the references in Column 2 and 3.

Item 10

### Financing

This section defines if the Franchisor offers any finance to assist you in obtaining the franchise.

Item 11

### Franchisors assistance, advertising, computer systems and training

This section explains all the things the Franchisor are agreeing to do, to assist you, in opening and operating your franchise.

Item 12

### Franchise Territory

This section explains how the Franchisor determines their territories.

Item 13

### Trademarks

They grant you the right to conduct business under their business name. You must not use any of the marks as part of your LLC or other corporate name. This is a common mistake that new owners make. It is important to understand the importance of this requirement. You should not file or set up an LLC using any part of the Franchisor’s company name. If you do so, they will require you to file under a different LLC or corporate name.

Item 14

### Patents, Copyrights and Proprietary Information

All franchise systems have Copyrights and Proprietary Information that is provided to you during the term of your agreement. Perhaps the most important thing to remember about this item is: you must never share with anyone outside of the system. In some cases, you might sign a non-disclosure and non-compete with all employees prior to sharing any of this information. Always be cautious of allowing employees to copy any of the material electronically on a device that you cannot control. If you find that an ex-employee is using this information you will have trouble enforcing the use of the information.

Item 15

### Obligations to Participate in the actual operation of the franchise business

Most Franchisors will require you or a designated manager to maintain control of the operation at all times. The individual that is managing the daily operation typically is required to attend mandatory meetings and training.

Item 16

### Restrictions on what the franchise may sell

You are only allowed to offer, promote and sell those products that the Franchisor have approved. It is easy to make a mistake and sell a product without approval. It is always best to check with the home office if you have any question at all.

Item 17

### Renewal, Termination, Transfer & Dispute Resolution

Typically, the franchise agreement is a 10-year agreement with one ten-year renewal. If you desire to renew at the end of your 10-year agreement you must notify the Franchisor in writing within the timeframe stated in their agreement.

Item 18

### Public Figures

The Franchisor will indicate if they use any public figures to promote their franchises.

Item 19

### Financial Performance Representations

The Federal Trade Commission only permits a Franchisor to discuss financial information with you, as outlined in their FDD. Item 19 is the financial information that most Franchisor have and disclose. To understand and use this information to estimate what your franchise might do financially you should make sure that you understand financial terms. I encourage you to ask the Franchisor information on this data, however, understand that they are not permitted to provide you with any specific information that is **not** addressed in the FDD. The Franchisor understands that you have specific questions relating to this information. I strongly suggest that you direct these questions to existing franchise owners.

**Item 20**

**Outlets and Franchisee Information**

The data in the charts state how many outlets have been in operation over the past 3 years. If the Franchisor has operated any company owned units during this period of time, they are listed as well. The next chart shows all transfers. The third chart in the series indicates the changes over the three-year period of actual franchise territories. In some cases, one individual may operate more than one franchise territory, which is why the number of territories may be greater than the number of franchisees.

**Item 21**

**Franchise Statements**

These are the Franchisor’s financial statements for the prior year (s) that have been prepared by an independent auditor.

**Item 22**

**Franchise Agreement**

Each year The Franchisor will prepare their franchise agreement. This is the exact same version of the franchise agreement that you will enter into. Although not required, it’s advised you take this to a franchise attorney for review. Upon your decision to enter a franchise agreement with the Franchisor, they will personalize the franchise agreement with your personal information and your territory.

**Item 23**

**Receipt**

This is the document that the Franchisor will need you to sign and return upon receipt of the FDD. This is not a commitment or obligation; it simply states the date that they sent you the document. Please take the time to sign, date, and mail this back to them.

**Exhibits**

The FDD also includes Exhibits. These exhibits will cover in no particular order: list of State Agents for Service of Process, Corporate Financials, State Addendum (if required), initial training program, list of franchise owners, Franchise Agreement, Non-Compete/Confidentiality/Non-Disclosure, Personal Guarantee and any specific exhibits for their franchise. You should write down questions you have regarding each item and prepare to discuss these questions at the time of your FDD Review.