

Managing the Sales Process

Legal Compliance

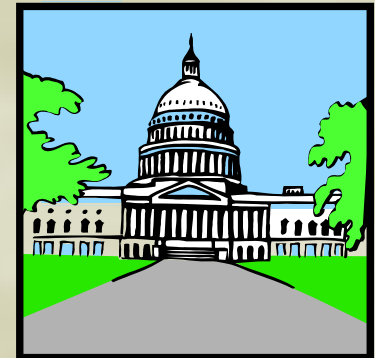
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Regulations

- UFOC - Disclosure - California 1969
 - Pre-sale registration of offering
 - Pre-sale disclosure



- FTC – 1979
- Applies in all States
 - 1999 – Notice of Proposed Rulemaking



Requirements

- Pre-sale delivery of UFOC to all prospects
- Prior registration or filing of a Uniform Franchise Offering Circular in some states
- Pre-sale disclosure and representations limited and defined
- Other requirements
 - Advertising approvals
 - Filing sales agent disclosure forms
 - Potential earnings restrictions/disclosure

Franchise Registration States

- California
- Hawaii
- Illinois
- Indiana - notice
- Maryland
- Michigan - notice
- Minnesota
- New York
- North Dakota
- Rhode Island
- South Dakota
- Virginia
- Washington
- Wisconsin - notice

Which format to use

- FTC v UFOC Format
 - Most franchisors use the UFOC format
 - Proposed FTC Rule to adopt UFOC format
- Multi-State UFOCs
 - State cover pages
 - Addenda – UFOC and agreements

Exemptions from Disclosure

- Exemptions
 - Oral agreements
 - Investment limits
 - Fractional franchises
- Exclusions
 - Renewals and extensions
 - Franchisee to franchisee sale – transfer of agreement
 - Single sale

Exemptions from Registration

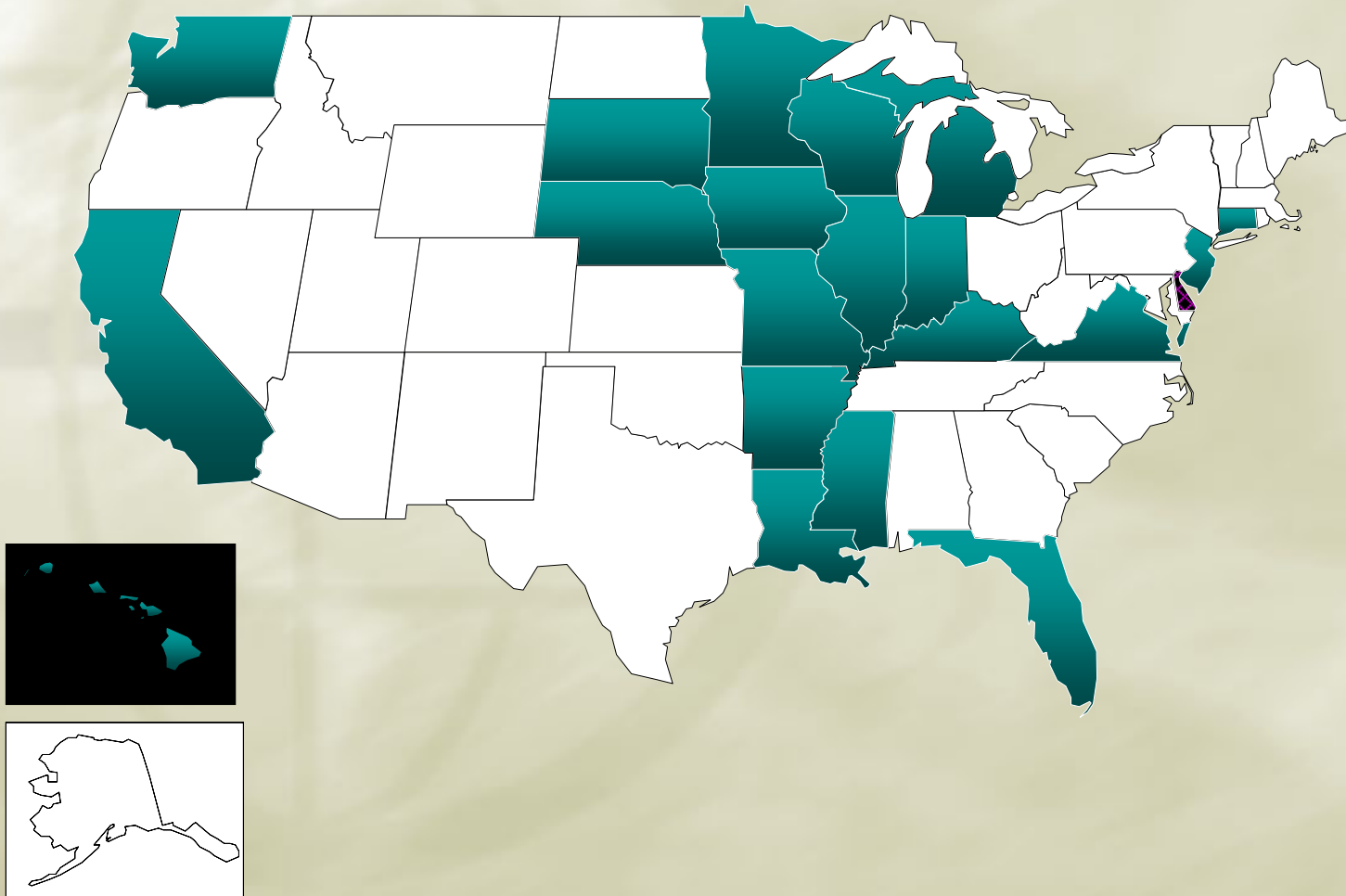
- Varies from state to state
- Large franchisors
- Seasoned franchisees
- Franchisee to franchisee

Franchisors need to monitor their exemption status

Business Opportunity States

- Alabama
- Alaska
- California
- Connecticut
- Florida
- Georgia
- Hawaii
- Illinois
- Indiana
- Iowa
- Kentucky
- Louisiana
- Maine
- Maryland
- Michigan
- Minnesota
- Nebraska
- New Hampshire
- North Carolina
- North Dakota
- Ohio
- Oklahoma
- Oregon
- South Carolina
- South Dakota
- Texas
- Utah
- Virginia
- Washington

Franchise Relationship Laws



Franchise Relationship Laws

- Termination
- Renewals
- Transfers
- Other

Updating the UFOC

- Amendments may be necessary when there are Material Changes
- There is a substantial likelihood that the changes will have an influence on the decisions of existing and prospective franchisees

What may be a material change

- It's often a judgment call
 - Litigation
 - Change in officers and directors – ie – CEO and majority of the board
 - Change in financial condition
 - Changes to franchise system
 - Changes in number of franchisees
 - Changes in franchise fee
 - Changes to investment

What happens when you amend

- Revisions to UFOC
- May require re-disclosure to prospective franchisees
- Registration States
 - File a revised blacklined with fees
 - Suspension of franchise offering pending approval
- Non-Registration States
 - May offer franchises as soon as amended documents available

Uniform Franchise Offering Circular

- Describes
 - the franchisor
 - its franchise program
 - the agreement
- Purpose is to assist prospect to make informed investment decision
- Purpose for franchisor is also as a sales tool

What's in the UFOC

- Identity and business experience of franchisor, predecessors and affiliates
- Identity and employment history of officers and directors
- Litigation history of franchisor, predecessors, officers & directors
- Bankruptcy history

What's in the UFOC

- Franchise fees
- Initial investment
- Required purchases
- Obligations of the parties under the franchise agreement
- Territorial rights and restrictions
- Trademarks

What's in the UFOC

- Patents, Copyrights and Proprietary Information
- Earnings Claim
- Statistics about franchisee locations and company-owned locations
- Financial Statements
- Agreements

Who should receive your UFOC

- Every prospective franchisee
 - Individuals – Partnerships - Corporate Entities
 - Guarantors
- Who is a prospective franchisee?
 - Any person including their representative or agent who approaches a franchisor or
 - Any person who is approached by a franchisor or its brokers, agents or representatives

For the purpose of discussing the establishment
of a franchise relationship

When to Provide a UFOC

- First Personal Meeting
 - Face-to-face meeting to discuss the sale of a franchise
- It may not be a first personal meeting if
 - Communication is by telephone or mail
 - Meeting is initiated by the prospective franchisee
 - From the start you state that you are not prepared to discuss the sale of a franchise
 - Meeting is brief and limited to generalized discussion
 - Trade shows

When to Provide a UFOC

- The 10 Business Day Rule
 - Franchisee should receive a UFOC at least 10 business days before the
 - Signing of an agreement
 - Payment of any fees
- The 5 Business Day Rule
 - Franchisee must have in their possession a completed franchise agreement and all other agreements at least 5 business days before they are signed
- Proposed FTC Rule moving to 14 calendar days

The 5 & 10 Business Day Rules

- May run concurrently
- Cannot be waived
- Is not a quiet period – important to keep in touch with prospective franchisee
- Important to obtain receipt page from UFOC to provide proof of disclosure

Electronic Delivery

- FTC pilot program with Franchise.com
- NASAA – September 14, 2003
 - May disclose through electronically
 - Must conform to legal requirements
 - Must be delivered in a single format
 - Must not have any extraneous information or links to or from other documents
 - Must be delivered in a format that can be printed and stored
 - Must provide proof of delivery

Jurisdictional Issues

- Jurisdictional Scope of State Laws
 - Where does the prospect live
 - Where will the prospects principal place of business be located
 - What is the territory covered by the agreement
 - Where are negotiations and discussions being held
 - What are the laws of the prospects home jurisdiction

Tips for Compliance

- Consider registration in all registration states
- Maintain a map indicated the states you are registered to offer
- Use a multi-state UFOC when practical
- Carefully analyze each transaction
 - Which UFOC to use
 - Document domicile or residence status
 - Territory or related provisions
 - Maintain record of all mail, calls and meetings
- When in doubt – ask your compliance officer and/or legal advisor

Jurisdictional Issues - Internet

- NASAA has established a safe harbor
- Adopted by most states
- Web-site disclosure language
 - Offer is not being made to residents of all states
 - No offer until the franchisor has met states requirements

Disclosure Issues - Transfers

- Disclosure may not be required
 - Sale by a franchisee of their own business
 - Franchisee finds their own buyer
 - Franchisor merely approved or disapproves franchisee
 - Franchisor merely charges a transfer fee
 - Franchisee assigns the existing franchise agreement

Disclosure Issues - Transfers

- Disclosure may be required
 - Franchisor requires new franchisee to sign the then current agreement
 - Franchisor introduced the new franchisee to the selling franchisee
 - Franchisor is involved in the negotiations between the parties
 - Franchisor requires proposed franchisee to attend discovery type day as opposed to meeting to assess prospects qualifications

Disclosure Issues - Transfers

- Disclose everyone?
 - Some disclose all new prospective franchisees to eliminate any analysis or future challenge
 - Could delay closure of sale
 - Unnecessary

Disclosure Issues - Renewal

- Limitations on non renewal may be subject to state laws
- Assuming a right to renew exists
 - May be conditioned on certain obligations
 - Then current franchise agreement
 - Timing and advance notice or renewal
 - Remodeling to then current standard
 - Renewal fee
 - General release

Potential Offering Errors

- Timely delivery of the UFOC
- Jurisdiction
- Earnings or other claims inconsistent with UFOC
- Misrepresentation of franchise offering
- Incomplete or incorrect UFOC
- Incomplete or incorrect records
- Transfers
- Renewals

Potential Sales Penalties

- Vary by jurisdiction
- No right of private action under the FTC Rule
- Several states provide for right of private action that may include rescission and/or damages
- Civil and/or criminal penalties against company and executives including jail
- Cease and desist orders
- Violation must be disclosed for 10 years in UFOC
- IFA/NFC FTC remediation program

Prevention Strategies

- Establish and enforce compliance program which includes:
 - Strong Compliance Officer
 - Agreed upon and clear compliance rules
 - Compliance Officer not easily overruled
 - Changes evaluated in a timely manner to determine materiality
 - Strict compliance with FTC/NASAA and other requirements
 - Maintain disclosure log

Prevention Strategies

- Don't close sale if there is a problem with receipt or 10 day/5 day rules
- Don't close if there are open issues from Compliance Checklist
- Complete Due Diligence Questionnaire and Process
- Complete Sales Representative Disclosure Form

Prevention Strategies

- Maintain complete franchisee files
 - Sales pitch and presentation
 - Signed acknowledgment of receipt
 - Sales and follow-up correspondence
 - Signed franchise agreement
 - Compliance Checklist
 - Due Diligence Questionnaire
 - Sales Representative Disclosure Form

Prevention Strategies

- Redisclose to prospective franchisees if UFOC is being amended
- Discuss with prospective franchisee before signing the agreement the sales process
- Deal directly and quickly with any issues that arise from discussions or records
- Routinely follow up on any issues raised by prospects with franchisor personnel and agents that are raised

Negotiating Changes

- Negotiations are not unusual or to be necessarily avoided
- They can deal with market issues situations
- They can deal with prospective franchisee issue
- They can facilitate a sale
- You can create different classes of franchisees in UFOC and prepackage “negotiated” changes

Negotiated Sales

- Negotiations may
 - May require a franchisor to disclose changes in amended UFOC
 - May require a “Notice of Negotiated Sale”
 - May be a required disclosure in future UFOCs
 - May raise anti-discrimination legal issues
 - May cause weakness in franchise system if negotiations went to standards or uniformity
 - May create dissention in franchise community

Dealing with Negotiated Changes

- All negotiations from standard form agreement
 - Reviewed by Compliance Officer
 - Reviewed with Operations Personnel
 - Reviewed with Leadership Structure per compliance program
 - Discussed with legal counsel for disclosure and agreement amendment
 - File proper documentation

Managing the Sales Team

- Sales representative disclosure form
 - Annually files
 - Most registration states
 - Franchisors can use an annual or periodic due diligence questionnaire
 - Consider as condition of employment a requirement to update franchisor by personnel if disclosable or other items change in their personal or business lives

Franchise Brokers

- Who is a broker
 - Any person, other than the franchisor who sells, offers for sale, or arranges for the sale of a franchise
 - Anyone who acts on behalf of one or more franchisors to further a franchise sale and receive a commission or other consideration if a sale is ultimately consummated – FTC staff advisory opinion

Requirements for Brokers

- Must be disclosed in Item 2 of the UFOC
- Litigation and bankruptcy must be disclosed in Items 3 and 4 of the UFOC
- Sales representative disclosure form filed in most of the registration states
- Updates to brokers personnel – may need to be disclosed – depending on materiality may require amendments

Requirements for Brokers

- Face to Face meeting between broker and prospect triggers disclosure requirements
- Lead generators, lead referral sources, lead referral networks that provide leads to franchisors for a fee, are considered brokers regardless if they are directly involved in the actual sale

Training

- A solid franchise sales compliance training program and training manual should be created
- All sales personnel and other staff that deal with prospective franchisees should routinely receive training
 - Company's UFOC
 - Franchise Offering Material
 - Franchise Sales Language – do and don't
 - Franchise Sales Compliance

Working with Brokers

- Considerations when working with brokers and lead generation networks
 - Provide the broker network any standards set by the franchisor for conducting sales of franchises and require the brokerage to abide by those standards
 - Require notification upon any changes to the broker's network/brokers that could impact the franchisor or its disclosure requirement
 - Require completion of Uniform Salesperson Disclosure Form, registration application, consent to service of process as and where required

Working with Brokers

- Require certification that brokerage has conducted appropriate due diligence on brokers in their network
- Request indemnification for sales activities of the brokerage
- Request Errors and Omissions and Broad Liability insurance coverage listing the franchisor as an additional insured
- Require the broker to notify if there is any pending or threatened litigation or regulatory action taken against any of the broker's other clients that may impact the franchisor

Working with Brokers

- Prior to closing on a franchise sale, a written statement that the broker has not violated any of the offering rules and that they have followed the policies of the franchisor as they relate to the offering of franchises
- Review brokerage's web site to ensure that it does not include any claims or statements that would impact franchisor

Earnings Claims

- Any written or verbal statement that claims, suggests or provides a formula for calculating a specific level or range of past or projected sales, costs, income or profit
 - When made an earnings claim must be disclosed in Item XIX of the UFOC
 - Franchisor must have a reasonable basis and be able to substantiate the information
 - Franchisor must be able to state the basis for any earnings claim and any assumptions on which based

Earnings Claims?

- You will earn \$2,000 per week.
- You will be able to retire by the time you are 45 years old.
- I reviewed the financial projections you included in your business plan – they look fine.
- Let me know what profit you expect – I will let you know if you are right.
- You should be able to break even in 18 months.
- We consistently get a 30% ROI.

Considerations in Making an Earning Claim

- Can protect the sales process.
- Can facilitate the sale.
- Is growing as a practice.
- Can disclose confidential information.
- Statistics and other non financial information may be a more accurate than unit financial information

Alternatives to Earnings Claim

- Refer prospect to existing franchisee
 - Take some care if existing franchisees are brokers – commission for facilitating sale
- Industry statistics and articles on industry including trade association
- Supplemental Earnings Claim
- Provide information to lending institution
- SEC Filings
 - For public companies, the requirements for disclosure under the SEC and the FTC are different, and can create difficulties

Earning Claims Prevention Strategies

- Adopt a clear policy that all earnings information must come from the UFOC
- Carefully substantiate any claims
- Provide continuing sales training to staff, brokers and necessary service providers
- Periodically have third party review of sales practices, marketing material and related literature
- Monitor activities of outside sales agents

Marketing your Franchise

- Advertising is defined as:

“any written or printed communication or any communication by means of recorded telephone messages or spoken on radio, television, or similar communications media, published in connection with an offer or sale of a franchise.” –
Maryland

Advertising Requirements

- Must avoid information that is false or misleading
- Submission generally not required outside of certain states
- Where exempt from sales registration there generally is an exemption from filing advertising with regulators

State Advertising Registration

State	Filing Days Prior to Use
• California	3 business days
• Maryland	5 days
• Minnesota	5 business days
• New York	7 days
• North Dakota	5 business days
• Rhode Island	5 business days
• South Dakota	3 business days
• Washington	7 days

Earnings Claims in Advertising

- The rules governing earnings claims include claims made in advertising
- When including earnings claims in ads – the FTC requires a franchisor to state:

“These figures are only estimates; there is no assurance you’ll do as well. If you rely upon our figures, you must accept the risk of not doing as well”

Advertising on the Internet

- NASAA Safe Harbor - March 1998
 - Encourages states to exempt internet offers from registration if franchisor
 - Uses cautionary language
 - Does not target anyone in the state
 - Does not sell its system in the state until formally registered

Advertising on the Internet

- NASAA Safe Harbor – 2001
 - Promotional material included on a web site or other electronic media does not constitute advertising subject to state filing
 - Franchisor's web sites should contain disclaimer language to take advantage of safe harbor

Proposed Changes to FTC Rule

- Eliminates FTC Rule Format and adopt UFOC Format
- Mandates use of the FTC modified UFOC format in all states but allows state specific pages if they provide greater protection
- Clarifies that FTC Rule does not apply to international transactions
- Applies only to franchise rules – Business Opportunities will have a separate rule

Proposed Changes to FTC Rule

- Creates new exemption for large investments (\$1.5 million) and large corporate franchisors with \$5 million net worth + 5 yr. history)
- Eliminates the first personal meeting and replaces the 10 and 5 days business day rule with 14 and 5 calendar day rules
- Permits disclosure through electronic media
- Does not require mandatory earnings claim but does require a statement that they are permitted

Proposed Changes to FTC Rule

- Requires modifications to UFOC format including:
 - Disclosures in 1-4 will include parents and broader definition of predecessor
 - Disclosure of franchisor initiated litigation will be required
 - If territories not provided a statement regarding intra-brand competition
 - Disclosure of gag clauses will be required in Item 20
 - Disclosure of trademark specific franchisee associations and new table to track turnover

Recruiting Franchisees

- Create a profile of the ideal candidate
- Follow a defined process that enables vetting of all of the candidates
- Be careful on the use of language
 - We are not selling franchises
 - We are not selling our system
 - They are not buying a franchise
 - We are approving franchisees
 - They are becoming franchisees

General Profile of a Franchisee

- Willingness to follow a system – entrepreneur lite
- Enthusiasm for the concept
- Track record for success in other endeavors
- Stable employment history
- Willingness to take risk
- Financially capable
- Understanding of business principles
- Ability to work independently

"Buying" a Franchise is Emotional

- Investing in a franchise is 90% emotions
 - Make them see themselves in the business and trust the franchisor the sale is made
 - One person working with a candidate
 - Establish rapport
 - Establish trust
 - Allows for clear communication
 - Diminishes chances for conflict
- Eliminate the poor candidates early – they will drain the system over time

Actively Recruit

- Provide candidates with information to move to the next step
- Make certain the information is clearly understandable and understood
- Use the process of discussion to predict the franchisees attitudes over time
- The selling process establishes the long term franchisor – franchisee relationship

What franchisors have to offer

There are three things a franchisor has to offer to a prospective franchisee:

- It's Brand
- It's Consumer system
- It's Franchise support system

Protection and Selection

To protect our offerings we need to first:

- Select the right franchisees
- Ensure that the franchisee knows what they are buying

The Mission

- The company must be committed – not only to a franchise expansion strategy but to a clearly defined franchisee support strategy

The Basics

- There is no magic to the franchisee recruitment process
- There are also no shortcuts

Internalizing the Team

Understand the difference between

- Outsourcing lead generation

vs.

- Outsourcing the recruitment and selection process

Lead Generation

- All lead generation is in some way outsourced:
 - Web sites
 - Advertising
 - Public relations
 - Existing franchisees
 - Trade shows
 - Web referral services

The Trouble with Candidates Today

- Prospective franchisees are more sophisticated and knowledgeable about franchising than ever before
- Prospective franchisees have more investment options than ever before

Speed – Clarity - Professionalism

- Three things they expect and demand from the process
 - Speed in response to their inquiry
 - Knowledgeable answers about the opportunity – hard sales techniques turn them off
 - Professionalism in the process and in the organization

The Internal Requirements

- Speed
 - E-commerce inquiries are not the only ones that need an instantaneous response
 - The candidate will move on to another opportunity unless they can speak to you or hear from you now

The Internal Requirements

- Knowledgeable answers
 - You may be interesting in the sale - but
 - They're more interested in the opportunity

The most productive salespeople have operated the business

The Internal Requirements

- Professionalism
 - Conveying the dedication of the system to supporting their objectives
 - Conveying to the candidate the selection process
 - Executing on the promises

The Internal Team

- Integrated and coordinated
 - All members of the internal team should be aware of recruitment process
 - Recruitment team
 - Compliance Officer
 - Operations and Training
 - Administration
 - Finance
 - Legal
 - Executive

The Internal Team

- All member of the internal team should be:
 - Trained
 - Scripted, and
 - Available – within the process guidelines

to support the process and answer the candidates questions

First personal contact

- Even where automated web responses are in place:
 - All candidates should be contacted immediately
 - Trained sales administrators
 - Franchise recruitment personnel
- All sales contacts should be logged immediately to facilitate tracking

Recruitment Personnel

- Responsible for screening all candidates
- Guiding all qualified candidates through the approval process
 - Getting information to/from the candidate
 - Getting information to/from other internal team members

Franchise Compliance Officer

- Makes sure that all the I's have dots and T's are crossed during the process
- Compliance program is a continuing process

Other Internal Team Members

- Gauge candidate's ability to succeed in the system
 - Knowledge skills and ability
 - Personality and attitude fit
 - Realistic commitment

A Team Decision

- It should never be a sale
- It must be a selection
 - Ensures everyone can get behind the new franchisee
 - Eliminates the “blame game” for a bad decision

A Team Effort

- All support areas must be committed to the new franchisee's start
- Bonus and other compensation
 - Other support team members
 - Deferred based upon performance

The Approval Process

- Pre-Qualification
- Sending Information
- Set Up File
- Follow up and Second Phone Call
- Discovery Day
- Follow Up
- More Follow Up
- Decision Day
- Closing the Prospect

Managing the Sales Process

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