

# Practical Advice

Franchising & Distribution Practice

## Franchising: What's In It For You?

Franchising is an excellent way to grow a business rapidly, penetrate new markets and leverage investment from the capital infusion and energy of franchisees.

As a business model, franchising opens avenues for brand expansion. But franchising is also a regulated practice. This means that launching a franchise system requires serious commitment. Some prefer to avoid the term 'franchising' by calling their business structure something else – a license, direct selling, joint venture, sales agency, distribution or partnership.

### **"If it quacks like a duck ... it's a duck."**

At the end of the day, if a business meets the definition of a franchise, then it will be considered a franchise under state law and federal regulation. Simply put, the definition of a franchise hinges on having three components. If all three exist, then the business structure is a franchise.

<b>FEE STRUCTURE</b>	Requires payment of a minimal fee to the franchisor.
<b>TRADEMARK</b>	Licenses to the franchisee the right to distribute goods or services under, or operate using, the franchisor's trademark or commercial symbol.
<b>CONTROL</b>	Provides a marketing plan or renders significant assistance to the franchisee in operating its business or the franchisee's method of operation.

Why does the characterization of a business matter? Because the federal government and more than a dozen states regulate the offer and sale of franchises. Franchise regulation is a response to perceived abuses in the franchise sales process, such as:

- Unfulfilled promises
- Excessive/baseless earnings and sales projections
- Fly-by-night operators taking fees and skipping town
- Other deceptive business practices

Regulations from the Federal Trade Commission and laws in certain states protect franchise purchasers. Businesses that sell franchises must use a detailed "Franchise Disclosure Document" (FDD) that includes information that promotes informed business decisions and comparison-shopping. The purpose of the FDD is to provide would-be franchisees with information about the franchise offering in a straightforward way that is easy for a layperson to understand. All FDDs, no matter what type of business – fast food restaurant, plumbing business or fitness center – must provide the same types of disclosures as well as minimum "cooling-off" periods to discourage hard-sell tactics.



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Failure to comply with franchise laws can have dire legal consequences – asset freezes, monetary penalties, rescission obligations and even criminal liability. Many companies fall into the “Accidental Franchise” trap, which requires curative measures if the proper legal strategy is not mapped out before the franchise offer. One legal strategy is to eliminate one of the three components (fee, trademark license or control), but this often diminishes business success. Usually, the better legal strategy is to comply with franchise laws and avoid the uncertainty of business and legal exposure.

However, certain exemptions remain. Businesses who meet those exemptions are not required to comply with franchise laws. While most business do not meet those exemptions, we make great efforts to help our clients explore them.

## PREPARING TO LAUNCH A FRANCHISE

**We recommend the following first steps for clients committed to pursuing franchising:**

**DEVELOP** an up-and-running profitable business to provide proof of concept.

**RESEARCH** competitors in the industry.

**CONSIDER** whether the concept will be profitable for franchisees. Analyze start-up costs and proposed initial franchise fees and factor in ongoing royalties and other continuing fees.

**DRILL DOWN** on the costs to launch a franchise system and support to franchisees (accountants, legal fees, potential franchise consultants and new personnel, like trainers).

**TALK** to a franchise consultant. Businesses retain these industry professionals to provide a variety of services, such as market research, drafting operations manuals and gathering information to prepare the FDD. We can recommend a reputable and cost-effective consultant.

**ORGANIZE** the guidelines that will comprise the “Operations Manual,” including processes, procedures and operation methods. Key topics

include: business overview, initial training, marketing and advertising, approved suppliers, required equipment, materials, customer service, site selection (if applicable), initial inventory and insurance, among others.

**CONFIRM** that the business owns a federally registered trademark, and, if necessary, take steps to federally register all trademarks associated with the brand. We offer this service as part of our “Start-Up Program” for franchisor clients.

**ENGAGE FRANCHISE COUNSEL** to draft the FDD, the franchise agreement and related documents and provide guidance on best practices for offer and sale. Fox Rothschild has a team of franchise attorneys who can help every step of the way.

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