Supporting Statement
Trade Regulation Rule on Disclosure Requirements and Prohibitions Concerning Franchising
(OMB No. 3084-0107)

1. Necessity for Collecting the Information

In 1978, the Federal Trade Commission ("FTC" or "Commission") issued the original Trade Regulation Rule on Disclosure Requirements and Prohibitions Concerning Franchising, 16 C.F.R. Part 436 ("Franchise Rule" or "Rule"), after concluding that lengthy investigations and a rulemaking proceeding revealed evidence of widespread deceptive and unfair practices in the sale of franchises and business opportunities. The Commission's investigation disclosed that prospective purchasers often found it difficult to obtain reliable information about proposed franchise and business opportunity investments and to otherwise verify the representations of the sellers and brokers offering them for sale.

The Rule requires franchisors and franchise brokers to furnish to prospective investors a disclosure document that provides information relating to the franchisor, the franchisor's business, the nature of the proposed franchise relationship, and additional information about any claims concerning actual or potential sales, income, or profits for a prospective franchisee ("financial performance claims"). The franchisor must also preserve the information that forms a reasonable basis for such claims.

The Rule requires all disclosures to: (1) be made at least 14 calendar days before any sale; and (2) use disclosure documents that comply with the form and content set forth in the Rule. It does not regulate the substantive terms of the franchisor-franchisee relationship. Nor does it require registration of the offering or the filing of any documents with the Commission in connection with the sale of franchises.

Revisions to the Rule[1] took final effect on July 1, 2008 after a one-year phase-in. Among other things, the amendments accomplished five objectives. First, the amendments address the sale of business format and product franchises exclusively.[2] Second, the amendments minimize prior inconsistencies between federal and state disclosure requirements by merging the Rule's disclosure requirements with the Uniform Franchise Offering Circular ("UFOC") disclosure format accepted by the 15 states that have franchise registration and disclosure laws.[3] Third, the

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[1] 72 Fed. Reg. 15,444 (Mar. 30, 2007).

[2] The disclosure and recordkeeping requirements applicable to business opportunity ventures, which were covered by the Franchise Rule prior to July 1, 2008, are separately set forth in 16 C.F.R. Part 437, and are covered under OMB Control Number 3084-0142.

[3] Before July 1, 2008, when the amended Rule took effect, some 95 percent of all franchisors used the UFOC disclosure format. As required by the amended Rule, and permitted by all state franchise laws,

amendments require the disclosure of more information on the quality of the franchise relationship, such as litigation franchisors initiate against their franchisees and the existence of any franchisee associations. Fourth, the amendments recognize new technologies by permitting franchisors to furnish disclosures electronically, whether by CD-ROM, email, or access to a Web site. Finally, the amendments reduce compliance costs by creating disclosure exemptions for sophisticated investors and for sales to franchisor "insiders" who are already familiar with the franchise system's operations.

2. Use of the Information

Prospective franchisees use the disclosures required by the amended Franchise Rule to become better informed about the proposed investment and to verify representations made by a franchisor.

If the franchisor chooses to make financial performance claims, disclosures are necessary for analyzing the credibility of those claims. For example, a franchisor might represent to a prospective franchisee that the franchisee should expect annual sales of $500,000. Without the Rule, the franchisee may have difficulty in assessing the accuracy or reliability of the claim. To make sure the franchisee can accurately assess the claim, the Rule requires the franchisor to: (1) indicate the number and percentage of franchises whose performance equaled or exceeded the claim; and (2) preserve and offer to show prospective franchisees the background material upon which the claim is based. This allows the prospective franchisee to form an independent judgment about the reliability of the claim. It also discourages the use of unrealistic financial performance claims, because the franchisor knows that the franchisee can determine whether an earnings claim is credible by examining the background material. The Rule also requires that any background material must be shown to the Commission in the course of any compliance investigation so that the Commission may evaluate whether the basis for the claim is reasonable.

3. Consideration of Using Improved Information Technology to Reduce Burden

Consistent with the aims of the Government Paperwork Elimination Act, 44 U.S.C. § 3504 note, the amended Rule permits franchisors greater latitude in using new technologies, in particular the Internet, to further reduce compliance costs. Franchisors are now able to reduce significantly printing and distribution costs through the expanded use of email and the Internet to furnish disclosure documents. 16 C.F.R. §§ 436.2(c), 436.6(g). The Rule also permits the use of electronic signatures and electronic recordkeeping. 16 C.F.R. §§ 436.1(u), 436.6(h); *see* 72 Fed. Reg. at 15,517-18.

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franchisors now must use the Franchise Disclosure Document ("FDD") format, which, in turn, has incorporated the UFOC's requirements.

4. Efforts to Identify Duplication/Availability of Similar Information

The fifteen states with franchise disclosure laws similar to the Rule previously required the use of the UFOC disclosure format, and would not accept disclosures in the format prescribed by the original Franchise Rule.[4] The amended Rule directly avoids any possible duplication. Since it took effect on July 1, 2008, the FDD disclosure format prescribed by the amended Rule has provided a single disclosure that can be used in all of the franchise registration states because it incorporates the UFOC requirements.

5. Efforts to Minimize Burden on Small Businesses

Unlike most state franchise disclosure laws, the Rule does not require the franchisor to register or file disclosure documents with the government before offering or selling a franchise. Thus, compliance with the Rule does not involve the fees usually associated with registering or filing state disclosure documents, a consideration that might be especially important to small businesses.

Also, since August 1998, Commission staff have participated in an alternative law enforcement program initially organized by the National Franchise Council and now operated by the International Franchise Association ("IFA"), a trade association whose membership consists of both franchisors and franchisees. The IFA's members include many small businesses in addition to some of the country's largest franchisors. Under the IFA's alternative law enforcement program, a firm accused of violating the Franchise Rule has three options: (1) sign a consent decree in U.S. district court; (2) be sued by the FTC; or (3) go to the IFA for training, compliance monitoring, and, where appropriate, mediation of franchisee claims. Firms do not need to be IFA members in order to participate. The FTC oversees the program, deciding which types of violations are appropriate for a referral to the IFA, as well as the terms of compliance monitoring. In addition, aggrieved franchisees may seek money through the program's third-party mediator. The program is limited to disclosure problems only, and does not cover hardcore fraud cases. The FTC will continue to handle all serious fraud cases and many disclosure cases through traditional law enforcement, including seeking injunctions, redress, and civil penalties, where warranted. Because the FTC's law enforcement resources are limited, the alternative law enforcement program greatly helps the Commission in enforcing the Rule and increasing compliance.

6. Consequences of Conducting Collection Less Frequently

Reducing the frequency of disclosure under the Rule would not serve a useful end because it would deprive prospective franchise purchasers of material information that is up-to-date. The Rule requires only a one-time disclosure to a prospective purchaser, and

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[4] The Commission permitted the use of the UFOC while the original Franchise Rule remained in effect, in lieu of the Rule's disclosure format. Consequently, there was never any requirement that franchisors prepare one disclosure document for federal use, and another for use in franchise registration states.

minimizes the burden of information collection by requiring only annual updates of the mandated disclosures, unless there is a material change during the year. In that case, only a quarterly attachment updating the FDD is required to reflect that change.

7. Circumstances Requiring Collections Inconsistent with Guidelines

The collection of information in this Rule is consistent with all applicable guidelines contained in 5 C.F.R. § 1320.5(d)(2).

8. Consultation with Outside Sources

The Commission most recently sought public comment on the Paperwork Reduction Act (44 U.S.C. Chapter 35) ("PRA") aspects of the Rule, as required by 5 C.F.R. § 1320.8(d). See 79 Fed. Reg. 41,284 (July 15, 2014). No comments were received. The Commission is providing a second opportunity for public comment while seeking OMB approval to extend the existing PRA clearance for the Rule.

9. Payment or Gift to Respondents

Not applicable.

10. Assurances of Confidentiality

No assurance of confidentiality is necessary, since franchisors do not register or file any documents with the Commission. To the extent that information covered by a recordkeeping requirement is collected by the Commission for law enforcement purposes, the confidentiality provisions of Sections 6(f) and 21 of the FTC Act, 15 U.S.C. §§ 46(f), 57b-2 will apply.

11. Sensitive or Private Information

Under the provisions of the amended Rule, a franchisor must disclose certain franchisees' names, business addresses, and telephone numbers. Disclosing this information lets prospective franchisees conduct their own due diligence investigation of the franchisor's claims, in particular financial performance claims. No other information about individual franchisees must be disclosed. For example, franchisors that choose to make a financial performance claim based upon the earnings history of current franchisees need not identify in the disclosure document the individual franchisees whose information formed the basis of the earnings claim, or the earnings of any individual franchisee or franchised location.

12. Burden Estimate

Estimated annual hours burden: 16,750 hours

Based on a review of trade publications and information from state regulatory

authorities, staff believes that, on average, from year to year, there are approximately 2,500 sellers of franchises covered by the Rule, with perhaps about 10% of that total reflecting an equal amount of new and departing business entrants. Commission staff's burden hour estimate reflects the incremental tasks that the Rule may impose beyond the information and recordkeeping requirements imposed by state law and/or followed by franchisors that have been using the FDD disclosure format nationwide. This estimate likely overstates the actual incremental burden because some franchisors, for various reasons, may not be covered by the Rule (e.g., they sell only franchises that qualify for the Rule's large franchise investment exemption of at least $1 million).

Staff estimates that the average annual disclosure burden to update existing disclosure documents will be three hours each for the 2,250 established franchisors, or 6,750 hours cumulatively for them, and 30 hours apiece each year for the 250 or so new entrant franchisors to prepare their initial disclosure documents, or 7,500 hours, cumulatively, for the latter group. These estimates parallel staff's 2011 estimates for the Rule. No public comments were received on those prior estimates; accordingly, the FTC retains them for the instant analysis subject to further opportunity for public comment.

As recognized in the 2011 analysis, covered franchisors also may need to maintain additional documentation for the sale of franchises in non-registration states, which could take up to an additional hour of recordkeeping per year. Assuming, as before, an hour of incremental recordkeeping per covered franchisor, this yields an additional cumulative total of 2,500 hours for all covered franchisors.

Under the Rule, a franchisor is required to retain copies of receipts for disclosure documents, as well as materially different versions of its disclosure documents. Such recordkeeping requirements, however, are consistent with, or less burdensome than, those imposed by the states. Accordingly, staff believes that incremental recordkeeping burden, if any, would be de minimis.

Based on the above assumptions and estimates, average yearly burden for new and established franchisors during a prospective three-year clearance would be 16,750 hours ((30 hours of annual disclosure burden x 250 new franchisors) + (3 hours of average annual disclosure burden x 2,250 established franchisors) + (1 hour of annual recordkeeping burden x 2,500 franchisors)).

Estimated annual labor cost burden: $3,597,500

Labor costs are derived by applying appropriate hourly cost figures to the burden hours described above. The hourly rates used below are estimated averages.

Commission staff anticipates that an attorney will prepare the disclosure document. Applying the above assumptions to an estimated hourly attorney rate of $250 yields the following yearly totals: $7,500 per new franchisor (or, $1,875,000, cumulatively, for new franchisors) and $750 per established franchisor (or, $1,687,500, cumulatively, for established

franchisors). Combined, then, cumulative labor costs for all covered franchisors to prepare the disclosure document is $3,562,500.

The FTC additionally anticipates that recordkeeping under the Rule will be performed by clerical staff at approximately $14 per hour.[5] Thus, 2,500 hours of recordkeeping burden per year for all covered franchisors will amount to a total annual labor cost of $35,000.

Cumulatively, then, total estimated labor cost under the Rule is $3,597,500 (($7,500 attorney costs x 250 new franchisors = $1,875,000) + ($750 attorney costs x 2,250 established franchisors = $1,687,500) + ($14 clerical costs x 2,500 franchisors = $35,000)).

13. Estimated Capital/Other Non-Labor Costs Burden

When initially developing cost estimates for this Rule, FTC staff consulted with practitioners who prepare disclosure documents for a cross-section of franchise systems. The FTC believes that its cost estimates remain representative of the costs incurred by franchise systems generally. In addition, many franchisors establish and maintain websites for ordinary business purposes, including advertising their goods or services and to facilitate communication with the public. Accordingly, any costs franchisors would incur specifically as a result of electronic disclosure under the Rule appear to be minimal.

As set forth in the 2011 Notices, FTC staff estimates that the non-labor burden incurred by franchisors under the Franchise Rule differ based on the length of the disclosure document and the number of them produced. Staff estimates that 2,000 franchisors (80% of total franchisors covered by the Rule) will print and mail 100 disclosure documents at $35 each. Thus, these franchisors would each incur an estimated $3,500 in printing and mailing costs. Staff estimates that the remaining 20% of covered franchisors (500) will transmit 50% of their 100 disclosure documents electronically, at $5 per electronic disclosure. Thus, these franchisors will each incur $2,000 in distribution costs (($250 for electronic disclosure [$5 for electronic disclosure x 50 disclosure documents]) + ($1,750 for printing and mailing [$35 for printing and mailing x 50 disclosure documents])).

Accordingly, the cumulative annual non-labor costs for the Rule is approximately $8,000,000 (($3,500 printing and mailing costs x 2,000 franchisors = $7,000,000) + ($250 electronic distribution costs + $1,750 printing and mailing costs) x 500 franchisors = $1,000,000)).

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[5] Based on mean hourly wages for file clerks found in "Occupational Employment and Wages – May 2013," U.S. Department of Labor, released April 1, 2014, Table 1, *available at* http://www.bls.gov/news.release/pdf/ocwage.pdf.

14. Estimate of Cost to Federal Government

Staff estimates that the annualized cost to the Commission (per year over the 3-year clearance renewal being sought) to administer and enforce the amended Rule will be approximately $120,000. This estimate includes attorney, clerical, and other support staff costs.

15. Changes in Burden

Not applicable.

16. Statistical Use of Information

There are no plans to publish any information for statistical use.

17. Failure to Display of the Expiration Date for OMB Approval

Not applicable.

18. Exceptions to the Certification for Paperwork Reduction Act Submissions

Not applicable.