

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 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 representations”). 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 Rule¹ took final effect on July 1, 2008 after a one-year phase-in. Among other things, the amendments accomplished five objectives. First, the amendments addressed the sale of business format and product franchises exclusively.² Second, the amendments minimized 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 amendments required 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 recognized new technologies by permitting

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

franchisors to furnish disclosures electronically, including by email and posting on the Internet. Finally, the amendments reduced 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 potential franchise investments and to verify representations made by a franchisor.

If the franchisor chooses to make financial performance representations, 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 would 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 representations, because the franchisor knows that the franchisee can determine whether the representation 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 Rule permits franchisors greater latitude in using new technologies, in particular the Internet, to reduce compliance costs. Franchisors may reduce significantly printing and distribution costs by using 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.

4. Efforts to Identify Duplication/Availability of Similar Information

The Rule avoids potential duplication of state laws. 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 states that have franchise registration and disclosure laws because it incorporates UFOC requirements.⁴

⁴ 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. 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.

5. Efforts to Minimize Burden on Small Businesses

Unlike most state franchise disclosure laws, the Rule does not require a 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 burdens or fees typically associated with registering or filing disclosure documents with states, a consideration that may be especially important to small businesses.

6. Consequences of Conducting Collection Less Frequently

Reducing the frequency of disclosure under the Rule 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 minimizes the burden of information collection by requiring only annual updates of the mandated disclosures, unless there is a material change during the year. Where a material change has occurred, only a quarterly update to the FDD is required to reflect the change. In addition, when providing the FDD to a prospective franchisee, the franchise seller must also notify the prospective franchisee of any material changes that the seller knows or should have known occurred in the information contained in any financial performance representation.

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

Consistent with 5 C.F.R. § 1320.8(d), the Commission recently sought public comment on the Paperwork Reduction Act (44 U.S.C. Chapter 35) (“PRA”) aspects of the Rule. *See* 85 FR 19479 (Apr. 7, 2020). No relevant 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 Rule, a franchisor must disclose certain franchisees' names, business addresses, and business telephone numbers. Disclosing this information lets prospective franchisees conduct their own due diligence investigation of the franchisor's claims, in particular financial performance representations. No other information about individual franchisees must be disclosed. For example, franchisors that choose to make a financial performance representation based upon the earnings history of current franchisees need not identify in the FDD the individual franchisees whose information formed the basis of the earnings claim, or the earnings of any individual franchisee or franchised location.

12. Estimated Annual Hours and Labor Cost Burden

Estimated annual hours burden: 16,750 hours

Based on information from state regulatory authorities and relevant trade journals, staff estimates that there are approximately 2,500 sellers of franchises covered by the Rule, with approximately 10% of that total reflecting an equal amount of new and departing business entrants.⁵ This estimate may overstate the number of covered franchisors 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 for established franchisors to update existing disclosure documents will be three hours per seller for a total of **6,750 hours** (2,250 franchisors × 3 hours). Covered franchisors also may need to maintain an alternative version of the FDD for use in non-registration states, which may differ from FDDs used in registration states. Staff estimates that this recordkeeping obligation would require approximately one hour per year. This results in an additional burden of **2,500 hours** (2,500 franchisors × 1 hour). This results in a combined burden for disclosure and recordkeeping by established franchisors of **9,000 hours**.

For new franchisors, staff estimates that preparation of disclosure documents by new sellers of franchise opportunities will require approximately 30 hours for a total of **7,500 hours** (250 new franchisors × 30 hours).

Under the Rule, a franchisor is also required to retain copies of receipts of 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 that have franchise registration and disclosure laws. Accordingly, staff believes that incremental recordkeeping burden, if any, would be *de minimis*.

Accordingly, the estimated burden hours associated with the Rule total **16,750 hours**.

⁵ This number appears consistent with the number of business format franchise offerings registered in compliance with state franchise laws, and listed in franchise directories.

Estimated annual labor cost burden: \$1,037,125

Labor costs are derived by applying estimated hourly cost figures to the burden hours described above.

FTC anticipates that an attorney will prepare or update required disclosure documents at an approximate hourly rate of \$69.86.⁶ For established sellers, FTC staff estimates the following annual labor costs: \$210 (rounded to the nearest dollar) per established franchisor (3 hours × \$69.86) for a total annual cost burden of **\$472,500** for established franchisors (\$210 × 2,250 established franchisors). For new franchisors, this yields an annual cost of \$2,096 (rounded) per new franchisor (30 hours × \$69.86) for a total annual cost burden of **\$524,000** for new franchisors (\$2,096 × 250 new franchisors).

The FTC additionally anticipates that recordkeeping under the Rule will be performed by clerical staff at approximately \$16.25 per hour.⁷ Thus, 2,500 hours of recordkeeping burden per year for all covered franchisors will amount to a total annual labor cost of **\$40,625**.

Accordingly, the total estimated labor cost under the Rule is **\$1,037,125**.

13. Estimated Capital/Other Non-Labor Costs Burden

In 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 franchisors generally.

FTC staff estimates that the non-labor burden incurred by franchisors differs based on the length of the disclosure document, the number produced, and the method of distribution employed by franchisors. Staff estimates that the estimated 2,500 sellers of franchise opportunities distribute approximately 100 disclosure documents each annually for a total of 250,000 disclosure documents. Staff estimates that 80% of these disclosure documents are distributed in hard copy format at a cost of \$35 each for printing and mailing costs. This results in a total estimated **\$7,000,000** in non-labor costs for printing and mailing disclosure documents (200,000 × \$35).

Staff estimates that the remaining 20% of disclosure documents (50,000) are distributed electronically, at a cost of \$5 per electronic disclosure. This yields a total non-labor cost burden of **\$250,000** for electronic disclosures (50,000 × \$5).

Accordingly, the cumulative annual non-labor costs for the Rule is approximately **\$7,250,000**.

⁶ This figure is derived from the mean hourly wage for Lawyers. See “Occupational Employment and Wages—May 2019,” Bureau of Labor Statistics, U.S. Department of Labor (March 31, 2020), Table 1 (“National employment and wage data from the Occupational Employment Statistics survey by occupation, May 2019”), available at <https://www.bls.gov/news.release/pdf/ocwage.pdf>.

⁷ Based on mean hourly wages for file clerks found in Table 1. “National employment and wage data from the Occupational Employment Statistics survey by occupation, May 2018,” at <https://www.bls.gov/news.release/ocwage.t01.htm>.

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. Adjustments

As part of the renewal, FTC staff has revised its Information Collection to better reflect burden estimates associated with the Franchise Rule. The FTC previously used three separate Information Collections to reflect the capital and non-labor costs associated with franchisors' disclosure of franchise disclosure documents via mail or electronic distribution: (1) "Franchisors solely printing & mailing disclosure documents"; (2) "Franchisors printing & mailing 1/2 of their disclosure documents"; and (3) "Franchisors electronically transmitting 1/2 of their disclosure documents."

The FTC has consolidated these three Information Collections into two revised Information Collections titled (1) "Capital/Non-Labor Cost for Printing and Mailing Disclosure Documents" and (2) "Capital/Non-Labor Cost for Electronic Distribution of Disclosure Documents." These retitled and consolidated Information Collections reflect FTC staff estimates that the 2,500 sellers of franchise opportunities distribute approximately 100 disclosure documents each annually for a total of 250,000 disclosure documents. Staff estimates that 80% of these disclosure documents (200,000) are distributed in hard copy format, while 20% (50,000) are distributed electronically.

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

The FTC certifies that this collection of information is consistent with the requirements of 5 CFR 1320.9, and the related provisions of 5 CFR 1320.8(b)(3), and is not seeking an exemption to these certification requirements.