

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

This is a request for approval of a three-year extension of an existing clearance. The FTC's Franchise Rule, 16 C.F.R. part 436, requires sellers of franchises to comply with certain disclosure and recordkeeping requirements in connection with the sale, or prospective sale, of a franchise. There is no change in the information collection.

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 franchisees 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 the franchisee signs a contract or makes a payment in connection with a franchise 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 states that have franchise registration and disclosure

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.

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 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.

For example, if a franchisor chooses to make financial performance representations, disclosures are necessary to enable a prospective franchisee to analyze the credibility of those claims. Accordingly, the Rule requires the franchisor to (1) provide specified information about the claims, 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 technology 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. 15444, 15,517 – 18 (Mar. 30, 2007).

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

³ Before July 1, 2008, when the amended Rule took effect, approximately 95 percent of all franchisors used the UFOC disclosure format. As required by the amended Rule, and permitted by all state franchise laws, franchisors must now use the Franchise Disclosure Document (“FDD”) format, which, in turn, has incorporated UFOC’s requirements.

can be used in all states that have franchise registration and disclosure laws because it incorporates UFOC requirements.⁴

5. Efforts to Minimize Burden on Small Businesses

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 in states with franchise disclosure or registration laws; 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, current information. With limited exceptions, the Rule requires only a one-time disclosure to a prospective purchaser, and the Rule 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. Public Comments/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* 88 Fed. Reg. 6727 (Feb. 1, 2023). 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.

⁴ The 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.

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: 22,480 hours.

FTC staff estimates that there are approximately 4,000 sellers of franchises covered by the Rule, with approximately 6% 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).

FTC 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 **11,280 hours** (3,760 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. FTC staff estimates that this recordkeeping obligation would require approximately one hour per year. This results in an additional burden of **4,000 hours** (4,000 franchisors × 1 hour). This results in a combined burden for disclosure and recordkeeping by established franchisors of **15,280 hours**.

For new franchisors, FTC staff estimates that preparation of disclosure documents by new sellers of franchise opportunities will require approximately 30 hours for a total of **7,200 hours** (240 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

⁵ This estimate is based, in part, on online research conducted by FTC staff. Some franchise offerings may qualify for the exemptions listed in 16 C.F.R. § 436.8. Thus, this estimate may overestimate the number of franchisors subject to the Rule.

recordkeeping requirements, however, are consistent with, or less burdensome than, those imposed by the states that have franchise registration and disclosure laws. Accordingly, FTC staff believes that incremental recordkeeping burden, if any, would be *de minimis*.

Accordingly, the estimated burden hours associated with the Rule total **22,480 hours**.

Estimated annual labor cost burden: \$8,386,800.

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

FTC staff anticipates that an attorney will prepare or update required disclosure documents at an approximate hourly rate of \$450.⁶ For established sellers, FTC staff estimates the following annual labor costs: \$1,350 per established franchisor (3 hours × \$450) for a total annual cost burden of **\$5,076,000** (\$1,350 × 3,760 established franchisors). For new franchisors, this yields an annual cost of \$13,500 per new franchisor (30 hours × \$450) for a total annual cost burden of **\$3,240,000** (\$13,500 × 240 new franchisors).

FTC staff additionally anticipates that recordkeeping under the Rule will be performed by clerical staff at approximately \$17.70 per hour.⁷ Thus, 4,000 hours of recordkeeping burden per year for all covered franchisors will amount to a total annual labor cost of **\$70,800** (\$17.70 × 4,000 hours).

Accordingly, the total estimated labor cost under the Rule is **\$8,386,800**.

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. FTC staff 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. FTC staff estimates that the estimated 4,000 sellers of franchise opportunities distribute approximately 100 disclosure documents each annually for a total of 400,000 disclosure documents. FTC staff estimates that 80% of these disclosure documents (320,000) are distributed electronically, at a cost of \$5 per electronic disclosure.⁸ This yields a total non-labor cost burden of **\$1,600,000** (320,000 × \$5) for electronic disclosures.

FTC staff estimates that the remaining 20% of disclosure documents (80,000) are distributed in hard copy format, at a cost of \$40 each for printing and mailing costs. This results

⁶ It is staff's understanding that franchisors often hire outside counsel to prepare the required disclosures, and outside counsel is typically compensated at a higher rate than in-house attorneys.

⁷ Based on the Bureau and Labor Statistics' Occupational Employment and Wages, May 2021, National Estimates for File Clerks, *available at* <https://www.bls.gov/oes/current/oes434071.htm>.

⁸ FTC staff estimates that this a reasonable cost estimate to prepare and electronically send the FDD.

in a total estimated **\$3,200,000** (80,000 x \$40) in non-labor costs for printing and mailing disclosure documents.

Accordingly, the cumulative annual non-labor costs for the Rule is approximately **\$4,800,000**.

14. Estimate of Cost to Federal Government

FTC 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 \$172,500. This estimate includes attorney, clerical, and other support staff costs.

15. Adjustments

There are no program changes. The differences in burden estimates from the prior clearance reflect (1) an increase in the number of covered entities, (2) an increase in labor costs associated with the preparation or updating of required disclosure documents, (3) an increase in printing and mailing costs, and (4) an overall decrease in non-labor costs as franchisors increasingly distribute the required disclosure documents by electronic means.

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 C.F.R. § 1320.9, and the related provisions of 5 C.F.R. § 1320.8(b)(3), and is not seeking an exemption to these certification requirements.