

Exemptions from the Federal Franchise Rule's Disclosure Requirements

The purpose of the franchise disclosure laws is to provide certain required information to a prospective franchisee so that he can make an informed decision whether or not to invest in a franchised business. Unless an exemption from the disclosure requirements of the franchise disclosure laws applies to the franchise transaction, a Franchise Disclosure Document (FDD) must be prepared and provided to a prospective franchisee before the franchisee signs the Franchise Agreement or gives the franchisor any money or other consideration.

The following are exemptions from the Federal Trade Commission's (FTC) federal franchise rule. These exemptions reflect the FTC's determination that due to the nature of the franchisor, the franchisee or the transaction, the protections of the federal franchise rule are not necessary. Therefore, the franchisor does not have to provide a FDD to prospective franchisees.¹

- **The Minimal Investment.**

The total of the required payments (or commitments to make a required payments) to the franchisor or its affiliate within the first six-month period after commencing business operations is less than \$540. Payments required to be made *after* the first six-month period are not included, even though a promissory note is signed during the first six-month period. Payments for the purchase of reasonable amounts of inventory at *bona fide* wholesale prices for resale or lease are also not included.

- **The Large Franchise Investment.**

The franchisee's total initial investment is at least \$1,084,900 and the franchisee acknowledges in a signed writing that the exemption applies due to the level of the investment. The investment excludes any financing received from the franchisor or its affiliate and the cost of unimproved land. This exemption cannot be satisfied by aggregating investments from multiple people; at least one person must individually satisfy this requirement.

- **The Large Franchisor.**

The franchisee (or its parent or affiliate) is an entity that has been in business for at least five years and has a net worth of at least \$5,424,500. The franchisee's business need not be the same as the franchised business.

¹ Certain states have franchise laws that must also be complied with. Some states require that an FDD be provided to prospective franchisees; some states require that the franchise offering be registered with state regulators; some states impose substantive requirements on the relationship between franchisors and franchisees for the benefit of franchisees. An exemption that may be available under federal law may not also be available under the states' laws applicable to the transaction.

- **The Insider Franchisee.**

A controlling interest (50%+) in the franchisee is owned by one or more individuals who, for at least two years within 60 days of the franchise purchase, (a) has been an officer, director, general partner or administrator of the franchised network, (b) has had management responsibility for the offer and sale of the franchisor's franchises or (c) has been an owner of a 25%+ interest in the franchisor.

- **The Fractional Franchise.**

The franchisee (or any of its current directors or officers, or the current directors of its affiliate) has more than two years' experience in the same type of business and the parties have a reasonable basis to anticipate that the sales arising from the relationship will not exceed 20% of the franchisee's total dollar sales volume during the first year of operations. Starbucks® operations in supermarkets frequently rely upon the fractional franchise exemption.

- **The Leased Department.**

The franchisee sells its goods and services from premises leased from a larger retailer in the retailer's store. The retailer cannot require the franchisee to purchase goods or services from the retailer or its designated suppliers. Macy's® leases space in its departments stores to Finish Line® for athletic footwear retailer, Lids® for athletic caps and Sunglass Hut® for sunglasses.

- **Oral Agreements.**

There is *no* written document that describes any material term or aspect of the relationship or arrangement. The existence of any such writing, such as a written purchase order or e-mail would eliminate the availability of this exemption.

- **Petroleum Marketers and Resellers.**

The franchise relationship is covered by the Petroleum Marketing Practices Act. The most common types of franchise relying upon this exemption are gasoline service stations.

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