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www.FranchiseDisclosure.com: Assessing the FTC's Proposed Franchise Rule Provisions Involving Electronic Disclosure

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I. INTRODUCTION

Ten years ago, few people would expect that they could choose, using a personal computer, which hotel they wanted to stay in when vacationing. Few people believed that they could use a computer to select which rental car they wanted to drive. Today, however, not only is browsing the Internet to find a rental car or hotel chain commonplace, but the ability to electronically search for which hotel or car rental *franchise* an entrepreneur wants to run will soon be just a click away.

The advancement of technology in the past decade has had a profound impact on the way business is conducted in the world today, and its effect on the increasingly popular business method of franchising has recently become the issue of debate among franchisors, franchisees, and the Federal Trade Commission (the "FTC"). Indeed, the FTC is currently considering amendments that account for changes in technology to the rule requiring potential franchise purchasers to receive disclosures about the company providing the franchise. The rule, entitled "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures"¹ ("Franchise Rule" or "Rule"), serves as a safeguard for potential entrepreneurs evaluating franchises ("franchisees"). By requiring companies that license their trademarks, business, or marketing systems ("franchisors") to furnish potential franchisees with a disclosure document containing detailed information about the franchisor and its business, the Franchise Rule provides a mechanism for potential franchisees to protect themselves from any fraudulent claims made by the franchisor.²

Prior to this proposed amendment, the franchisor was required, at great expense, to provide the prospective franchisee with a paper

1. 16 C.F.R. § 436 (1999).

2. *See* Proposed Collection; Comment Request, 64 Fed. Reg. 1203, 1205 (1999).

copy of the lengthy disclosure document.³ The proposed revisions to the Franchise Rule add an entire section⁴ that both allows the franchisor to provide the potential franchisee with the franchisor's disclosure document through electronic means, and enumerates certain limitations on the franchisor's use of electronic disclosure.⁵ At the FTC's request, both franchisors and franchisees submitted comments to the FTC concerning disclosure via electronic means.⁶ Additionally, the FTC held workshops in several cities to address this issue.⁷ While the FTC's initiative to allow electronic disclosure has generally been welcomed, franchisors and franchisees are concerned with certain aspects of proposed section 436.7.

Although the FTC is considering a myriad of other changes to the Franchise Rule, this Comment addresses only those proposed changes concerning disclosure through electronic means. Part II of this Comment provides background on the Franchise Rule. Part III describes the proposed amendments regarding electronic disclosure documents, discusses concerns raised by franchisors and franchisees, and makes recommendations that attempt to resolve those concerns. Part IV concludes that the proposed amendments regarding electronic disclosures are a step in the right direction, but the FTC should clarify certain subsections to further assist the franchisor in providing quick and accurate disclosure.

II. BACKGROUND

A. The FTC's Franchise Rule

The franchising method of conducting business has flourished since the 1950s.⁸ Based on information gathered from trade publications and state regulatory agencies, the FTC estimates that there were approximately five thousand franchise systems in the United States as of January 1999.⁹

3. See 16 C.F.R. § 436.1(a) (1999).

4. The proposed section is 436.7. See Franchise Rule, 64 Fed. Reg. 57,294 (1999) (to be codified at 16 C.F.R. pt. 436) (proposed Oct. 22, 1999).

5. See *id.*

6. See *id.*

7. See *id.* at 57,295.

8. See 1 HAROLD BROWN, FRANCHISING: REALITIES AND REMEDIES § 1.01[1] (1995).

9. Proposed Collection; Comment Request, 64 Fed. Reg. 1203 (1999).

The Franchise Rule was promulgated by the FTC in 1978 in response to the FTC's finding that there was a "serious informational imbalance between prospective franchisees and their franchisors."¹⁰ The FTC found that franchisors were defrauding and omitting material disclosures to prospective franchisees, resulting in "serious economic harm to franchisees."¹¹ Consequently, the Franchise Rule was adopted by the FTC to cure the informational imbalance between franchisors and their potential franchisees.

The FTC's Franchise Rule "[e]ssentially . . . requires specified, timely disclosure [of prescribed material information] to prospective franchisees."¹² The Rule "does not purport to regulate the substantive terms of the franchise relationship."¹³ Indeed, the Rule applies to the time period *before* the sale of a franchise. "[I]t requires franchisors to disclose material information to prospective franchisees on the theory that an informed consumer can determine whether a franchise deal is in his or her best interest."¹⁴ The franchisor must disclose all information enumerated in the Rule completely and accurately in either the FTC's specified format or in the Uniform Franchise Offering Circular ("UFOC") format.¹⁵ In general terms, the lengthy Franchise Rule¹⁶ requires that the franchisor disclose:

- (1) information about the franchisor and the franchise system, such as names of officers, litigation history, and number of franchises;¹⁷

10. Franchise Rule, 64 Fed. Reg. 57,294, 57,294 (1999) (to be codified at 16 C.F.R. pt. 436) (proposed Oct. 22, 1999).

11. *Id.*

12. LEGAL ASPECTS OF SELLING & BUYING § 9.65 (Philip F. Zeidman ed., 1983).

13. Franchise Rule, 64 Fed. Reg. at 57,294.

14. *Id.* See also 1 BROWN, *supra* note 8, at § 6.04[1] ("The purpose of the FTC regulation is to provide the prospective franchise with the factual information requisite to his [or her] making a meaningful decision on the investment opportunity.")

15. See LEGAL ASPECTS OF SELLING & BUYING, *supra* note 12, at § 9.65. The UFOC was "developed by state administrators and approved by a national association of state security administrators." *Id.* The North American Securities Administrators Association ("NASAA") subsequently adopted the UFOC in 1981. See *id.*

16. The text of the entire Franchise Rule is found in Part 436 of Title 16 of the Code of Federal Regulations. 16 C.F.R. § 436.1-4 (1999). Because the Rule contains numerous pages, only pertinent portions will be quoted in this Comment.

17. See Franchise Rule, 64 Fed. Reg. at 57,294.

- (2) its financial information including audited financial statements;¹⁸
- (3) material costs associated with the franchise and the provisions of the franchise agreement;¹⁹ and
- (4) information about former and current franchisees in the system.²⁰

Failure to abide by the Franchise Rule's disclosure requirements does not create a private right of action for the franchisee; however, the FTC can enforce its rule against noncompliant franchisors.²¹ In fact, the FTC has successfully challenged franchisors that have committed deceptive acts and practices when selling franchises.²² In addition to injunctive relief, the FTC has also received large sums of damages from noncompliant franchisors.²³ Therefore, franchisors take the Franchise Rule provisions very seriously. Currently, the franchisor provides the disclosure document—a very lengthy, multi-page paper version—to the prospective franchisee either at the first personal meeting between the franchisor and franchisee or ten days before any document is signed or money exchanges hands.²⁴

Sending volumes of disclosures to countless prospective franchisees can be very costly and inconvenient for the franchisor. For example, FRANDATA, a corporation that maintains a database of franchisor disclosure document information, concluded that a

18. *See id.*

19. *See id.*

20. *See id.*

21. *See* James R. Sims III & Mary Beth Trice, *The Inadvertent Franchise and How to Safeguard Against It*, FRANCHISE L.J., Fall 1998, at 54. As the authors point out, however, a franchisee may have the ability to “bootstrap” claims that the franchisor failed to disclose material information pursuant to the Franchise Rule if the applicable state statute has similar requirements. *See id.*

22. *See* 1 BROWN, *supra* note 8, at § 6.01[1][a].

23. *See* Sims & Trice, *supra* note 21, at 54. *See, e.g.*, Federal Trade Comm'n v. Minute-man Press, No. 93-CV-2496, 1998 WL 1069942, at *1 (E.D.N.Y. Oct. 5, 1998) (granting both injunctive relief and damages to the FTC); Federal Trade Comm'n v. Genesis One Corp., Bus. Franchise Guide (CCH) ¶ 11,060 (D.C. Cal. Mar. 4, 1996) (awarding injunctive relief, damages, and costs of action to the FTC); Federal Trade Comm'n v. Jordan Ashley, Inc., No. 93-2257-CIV., 1994 WL 200775, at *1 (S.D. Fl. Apr. 5, 1994) (awarding injunctive relief and five million dollars in damages to the FTC).

24. *See* 16 C.F.R. § 436.1(a) (1999). Changing the timing of the disclosure requirement is also under consideration by the FTC. This Comment, however, will focus only on amendments involving electronic disclosure methods.

franchisor's cost of complying with the Franchise Rule is approximately \$100 per disclosure document.²⁵ Considering that the average number of disclosure documents that a franchisor distributes annually is approximately 180,²⁶ the average yearly compliance cost for a franchisor is \$18,000. The FRANDATA estimate includes \$40 per disclosure document in printing and mailing costs and about \$60 per disclosure document in related labor and administrative costs.²⁷ Aside from the high cost of printing and sending paper disclosure documents, paper versions also take time to arrive at their destination. While a franchisor can hand deliver the documents to the franchisee, it still takes some time to get from point A to point B.

B. Electronic Disclosure: A New Medium for Disclosure

With the advent of technology, and more specifically the Internet, franchising disclosure has a potential new medium—electronic communication. This new medium has substantial benefits. For example, electronic disclosure has the potential to deliver disclosure documents instantly. Furthermore, FRANDATA projects that franchisor costs can be as low as \$5 to \$10 per document with development and implementation costs ranging from \$2,500 to \$10,000 per year.²⁸ For 180 disclosure document distributions, the high-end costs are \$11,800—significantly less than the \$18,000 paper copy distribution costs.²⁹ Moreover, potential franchisees will have the ability to easily access and compare multiple disclosure documents when franchise shopping on the Internet.

Recognizing the benefits of electronic disclosure, the FTC sought comments as early as 1995 from the public regarding the possibility of franchisees obtaining disclosure documents via the Internet.³⁰ In 1997, the FTC published an Advanced Notice of Pro-

25. See Letter from Jeffrey E. Kolton, President of FRANDATA, to Secretary, Federal Trade Commission 2-3 (Dec. 22, 1999) (available at <<http://www.ftc.gov/bcp/rulemaking/franchise/comments/comment029.pdf>>) [hereinafter FRANDATA comment].

26. See *id.*

27. See *id.*

28. See *id.*

29. The FRANDATA cost estimates do not include attorneys' fees, auditors' fees, or state registration fees, which would clearly result in higher total cost estimates. However, administrative and labor costs are significantly lower when the franchisor utilizes electronic disclosure methods.

30. See Request for Comments Concerning Trade Regulation Rule on Disclosure

posed Rulemaking (“ANPR”), which, among other things, solicited comments on how franchisors could comply with disclosure requirements over the Internet.³¹ One hundred and sixty-six comments were submitted in response to the ANPR, the majority of which came from franchisees or franchisee representatives.³² The FTC also held six “public workshop conferences” in six large cities to discuss the Rule and possible ways to improve it.³³ After considering the submitted comments and public discussions stemming from the ANPR, the FTC published a Notice of Proposed Rulemaking (“NPR”) on October 22, 1999, identifying several proposed amendments to the Franchise Rule and soliciting comments from the public regarding the proposed amendments.³⁴ Over thirty-five comments were submitted reacting to the FTC’s NPR, and now the franchise community awaits the FTC’s amendments to the Franchise Rule.

III. PROPOSED SECTION 436.7—ELECTRONIC DISCLOSURE DOCUMENTS

In addition to a new section regulating the use of electronic disclosure documents, the FTC proposed three new definitions relating to electronic disclosure.³⁵ Following a brief introductory note, this Part discusses each definition related to electronic disclosure. The remainder of this Part focuses on each subsection of proposed section 436.7, entitled “Instructions For Electronic Disclosure Documents.”³⁶ Section 436.7 contains seven subsections preceded by the following introductory language: “Franchise sellers can furnish disclosures electronically under the following conditions”³⁷ Specifically, this Part will identify the portions of the proposed Franchise Rule involving electronic disclosure; summarize the FTC’s reasoning

Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, 60 Fed. Reg. 17,656 (1995).

31. See Trade Regulation Rule on Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, 62 Fed. Reg. 9115 (1997).

32. See Franchise Rule, 64 Fed. Reg. 57,294, 57,295 (1999) (to be codified at 16 C.F.R. pt. 436) (proposed Oct. 22, 1999).

33. See *id.*

34. See *id.* at 57,294-350.

35. See *id.* at 57,298-99.

36. *Id.* at 57,345.

37. *Id.*

for the proposed amendments; discuss the concerns raised by franchisors, franchisees, and their representatives; and recommend certain changes to the proposed amendment that resolve the franchisors' and franchisees' concerns.

A. The FTC's Initiative

The FTC "does not wish to impede franchisors' ability to maximize the use of new technologies in their efforts to comply with the Rule."³⁸ The FTC recognizes that lower cost and greater efficiency and ease would result from allowing electronic disclosures.³⁹ The proposed amendments to the Rule include no "new sweeping requirements" relating to electronic disclosure.⁴⁰ "Rather, proposed section 436.7, for the most part, elaborates upon concepts that are already part of the Rule, in particular how to 'furnish' disclosures electronically and how to prepare 'clear,' 'concise,' and 'legible' disclosures in an electronic environment."⁴¹ There are, however, two new requirements to carry out the Rule's objective of protecting the prospective franchisee. Franchisors must provide prospective franchisees with a paper summary of the disclosure document, and franchisors must "retain a specimen hard copy of each materially different version of their disclosures."⁴²

Both franchisors and franchisees have overwhelmingly applauded the FTC's initiative but have also pointed to concerns regarding the use of electronic media. The subsections that follow highlight many of these concerns and suggest various ways in which those concerns should be addressed.

B. Proposed Electronic-Related Definitions

The proposed amendments to the Franchise Rule contain three new definitions pertaining to franchisors' provision of electronic disclosure documents: "Internet," "signature," and "written."⁴³

38. *Id.* at 57,316.

39. *See id.*

40. *See id.*

41. *Id.*

42. *Id.*

43. *See id.* at 57,298-99.

1. The proposed definition of "Internet"

The first new definition proposed by the FTC relating to electronic disclosures is the word "Internet." Section 436.1, the definitional section of the proposed rule, defines "Internet" as follows:

- (1) *Internet* means all communications between computers and between computers and television, telephone, facsimile, and similar communications devices. It includes the World Wide Web, proprietary online services, E-mail, newsgroups, and electronic bulletin boards.⁴⁴

In part, the definition in section 436.1 of "Internet" was modeled after the FTC's definition in the "Request for Comment on the Interpretation of Rules and Guides for Electronic Media,"⁴⁵ published in 1998.⁴⁶ Specifically, the 1998 Request for Comment involved the applicability of FTC rules to "electronic media," which encompassed "e-mail, CD-ROMs, and the Internet."⁴⁷ In turn, "Internet" was narrowly defined in a footnote as including "the World Wide Web as well as other electronic information-exchanging features, including 'Telnet,' 'FTP' (File Transfer Protocol), and USENET newsgroups. The [FTC] is using the term the 'Internet' to encompass the Internet and proprietary online services, such as America Online and Prodigy."⁴⁸ Conversely, the FTC attempts to broadly define "Internet" in the proposed Franchise Rule as "captur[ing] all communications between computers and between computers and television, telephone, facsimile, and similar communications devices."⁴⁹ In essence, the FTC appears to define "Internet" in the proposed Franchise Rule as broadly as it defined "electronic media" in the 1998 Request for Comment.

a. Franchisors' and franchisees' concerns. The FTC's proposed "Internet" definition has drawn some criticism. The FTC's definition of "Internet" in the proposed Franchise Rule varies from other commonly accepted definitions of the word. For example, the Ency-

44. *Id.* at 57,332.

45. Interpretation of Rules and Guides for Electronic Media; Request for Comment, 63 Fed. Reg. 24,996 (1998).

46. *See* Franchise Rule, 64 Fed. Reg. at 57,298 n.51.

47. Interpretation of Rules and Guides for Electronic Media; Request for Comment, 63 Fed. Reg. at 24,997.

48. *Id.* at 24,997 n.1.

49. Franchise Rule, 64 Fed. Reg. at 57,298.

clopaedia Britannica defines “Internet” as “a network connecting many computer networks and based on a common addressing system and communications protocol called TCP/IP (Transmission Control Protocol/Internet Protocol).”⁵⁰ A leading textbook in the computer science field defined the term in practically the same way, as a “network of networks [linked by] telephone lines, microwave links, and satellite channels.”⁵¹ In attempting to broaden the definition in the Franchise Rule, the FTC overlooks the fact that the Internet is a “defined” network and that it, with the addition of new technology, may evolve into other forms of media or may become obsolete. In either case, a regulatory definition that varies from the commonly accepted meaning will likely cause confusion, since most franchisees and franchisors will have a particular connotation with the term “Internet.”⁵² Furthermore, an altered regulatory definition may require the FTC to redefine or otherwise modify the Franchise Rule within a few years.

Another concern with the FTC’s proposed “Internet” definition is that it may exclude other forms of electronic media that exist or will exist in the future. Although the FTC attempts to resolve this concern by adding the words “similar communications devices” as a catch-all phrase, it also pronounces a list of different media included within the definition of “Internet.”⁵³ In effect, both current and future technologies that can transfer large amounts of data, such as a franchise disclosure document, may be excluded because of definitional constraints.

The word “Internet” is scarcely used in the proposed rule. There is frequent use of the phrases “electronic communication” and “electronic medium,” but the Rule fails to define them. The FTC explains that the definition of “Internet” is “necessary because, as explained in Section C.10 [of the NPR], the [FTC] proposes to amend the Rule to permit franchisors to comply with the Rule electronically.”⁵⁴ This statement implies that the franchisor complies with the Rule electronically if it provides its disclosure documents via the media

50. Encyclopaedia Britannica (visited Feb. 12, 2000) <<http://www.britannica.com>>.

51. ABRAHAM SILBERSCHATZ & PETER BAER GALVIN, OPERATING SYSTEM CONCEPTS 483 (5th ed. 1998).

52. For example, many people think that the “Internet” is only the World Wide Web, when, in fact, the World Wide Web is only one aspect of the Internet.

53. See Franchise Rule, 64 Fed. Reg. at 57,332.

54. *Id.* at 57,298.

enumerated under the definition of "Internet." The definition, however, bars the use of CD-ROMs, computer disks, and the like because they are not necessarily "communications" between computers. Furthermore, compact disks and computer disks do not fall within the commonly accepted definitions of "Internet." Regardless of the FTC's intent when defining the word "Internet," ambiguity exists and it must be clarified.

In response to the FTC's NPR, one commentator, Howard Bundy, expressed concern over both the use of this term and the definition supplied by the FTC.⁵⁵ Mr. Bundy correctly pointed out the inconsistency between defining the term "Internet" and using the term "electronic communication."⁵⁶ The term "Internet" connotes a specific meaning, unlike "electronic communication," which is used in proposed section 436.7.⁵⁷ Mr. Bundy contended that the term "electronic communication" is broader, and it should be defined in place of "Internet" in the following manner:

All forms of communication between wired and wireless electronic or digital communications devices and media capable of generating, storing, accessing, transmitting, delivering, receiving or displaying written information in any medium except paper or its equivalent, including between computers and between computers and television, telephone, facsimile, compact disks, digital video disks, floppy disks, personal communications devices, and similar communications devices and media. It includes communications over the World Wide Web, proprietary online services, extranets, intranets, e-mail, newsgroups, electronic bulletin boards, and similar or future technologies. The fact that an electronic communication is capable of being printed on paper or its equivalent does not convert it from an electronic communication unless it is, in fact, printed by the originator of the communication and distributed in paper or equivalent form.⁵⁸

55. See Letter from Howard E. Bundy, Attorney, to Secretary, Federal Trade Commission (Dec. 21, 1999) (available at <<http://www.ftc.gov/bcp/rulemaking/franchise/comments/comment018.htm>>) [hereinafter Bundy comment].

56. See *id.* at 4. This argument was echoed in at least one other comment. See Letter from John R.F. Baer, Franchise Attorney, to Secretary, Federal Trade Commission (Dec. 21, 1999) (available at <http://www.ftc.gov/bcp/rulemaking/franchise/comments/comment011.htm>>).

57. See Bundy comment, *supra* note 55, at 4.

58. *Id.*

The portion of the quote in italics is the segment that Mr. Bundy contended is a sufficient definition for the term “electronic communications” but added the remainder to clarify the definition at least for the next “few years.”⁵⁹ The recommended definition was supplied because the FTC’s “proposed definition may not encompass either personal communications devices (such as the Palm Pilot) or so-called ‘internet ready’ cellular telephones, each of which *may* develop the capacity to transmit or receive sufficient amounts of data.”⁶⁰ As a result, Mr. Bundy recommended avoidance of the word “Internet” and focus on the words “electronic communication.”⁶¹

b. Recommendation. Mr. Bundy recommended replacing the definition of “Internet” with the definition of “electronic communication” quoted above. However, because the term “Internet” is used in proposed section 436.7, as well as in the definition of “written” in proposed section 436.1(y), the FTC should not eliminate the definition of “Internet.” Because the term is widely used, and often incorrectly,⁶² defining the term is necessary. In addition, the FTC should add a definition to proposed section 436.1. Proposed section 436.7 allows a franchisor to furnish its disclosure document *electronically* to franchisees. However, the FTC does not define “electronic” or “electronic medium.” It instead provides only the “Internet” definition. The FTC should clarify this section by providing a very broad statement defining “electronic medium” that encompasses not only the Internet but also other forms of electronic communication. It should then provide a modified definition of the word “Internet.” A broad definition of each term will lessen the likelihood that the FTC will have to revisit the definitions too often with changes in technology. Conversely, narrow definitions will exclude other potential electronic media that exist or that will exist in the future that allow the franchisor to comply with the Rule. Therefore, proposed section 436.1(1) should include the following definitions for “electronic medium” and “Internet:”

(1) *Electronic medium* means all methods of communication involving electronic or digital devices or media, including but not

59. *See id.*

60. *Id.*

61. *See id.*

62. For example, many refer to the World Wide Web as the Internet, when, in fact, the World Wide Web is part of the Internet; the terms are not interchangeable.

limited to the Internet, compact disks, floppy or other computer disks, personal communications devices, and similar communications devices or media.

(2) *Internet* means all communications between computers and between computers and television, telephone, facsimile, and similar communications devices. It includes but is not limited to the World Wide Web, proprietary online services, E-mail, newsgroups, Telnet, FTP (File Transfer Protocol), electronic bulletin boards, and other electronic information-exchanging devices or media.

2. *The proposed definition of "signature"*

Another definition related to electronic disclosure in the Franchise Rule is "signature." The term "signature" will be a new addition to the Rule if this proposed amendment is accepted. Proposed section 436.1(w) states:

Signature means a person's affirmative steps to authenticate his or her identity. It includes a person's written signature, as well as a person's use of security codes, passwords, digital signatures, and similar devices.⁶³

The need for this definition stems from the Rule's requirement that the prospective franchisee sign a "receipt" form, acknowledging that he or she received the disclosure document.⁶⁴ With the proposed electronic disclosure amendments, the FTC is particularly concerned that the signature of receipt confirm the prospective franchisee's identity but defines the word to include "alternative means" of confirmation.⁶⁵

Although security concerns may arise, such as whether someone other than the prospective franchisee could obtain a confirming password, these concerns are primarily those of the franchisor, since it is the franchisor's burden to prove the franchisee received the disclosure document. The FTC has not and should not attempt to further shoulder the burden of dealing with security risks. Proposed section 436.7(w) is a welcome amendment, and its language should remain unchanged.

63. Franchise Rule, 64 Fed. Reg. 57,294, 57,333 (1999) (to be codified at 16 C.F.R. pt. 436) (proposed Oct. 22, 1999).

64. *See id.* at 57,299.

65. *See id.*

3. *The proposed definition of “written”*

The definition of “written” is an essential element to the proposed Franchise Rule, since it “clarifies that electronic media fall[s] within the ambit of a ‘written’ document.”⁶⁶ Proposed section 436.1(y) reads:

Written means any information in printed form or in any form capable of being preserved in tangible form and read. It includes: type-set, word processed, or handwritten documents; documents on computer disk or CD-Rom; documents sent via E-mail; or documents posted on the Internet. It does not include mere oral statements.⁶⁷

Although franchisors and franchisees did not comment upon this definition, it poses a problem similar to that raised in the discussion of the term “Internet” above.⁶⁸ That is, current or future technologies that are capable of being preserved in tangible form may not qualify as “written” because they are not included in the enumerated list of “written” media. For example, a new form of electronic medium, capable of being preserved and read in tangible form, may be developed in a few years that becomes widely used but is not a computer disk, CD-ROM, e-mail, or Internet document. Although it may be more convenient and less expensive for both the franchisor and the franchisee to fulfill the FTC requirements using this new method, it would not conform with the definition of “written” since the electronic medium is not listed in the current proposed definition. Thus, what follows is a recommendation for this definition with additions in italics:

Written means any information in printed form or in any form capable of being preserved in tangible form and read. It includes *but is not limited to*: type-set, word processed, or handwritten documents; documents on computer disk or CD-Rom, *or the like*; documents sent via E-mail; or documents posted on the Internet. It does not include mere oral statements.⁶⁹

In summary, the definitions of “Internet,” “signature,” and “written” are appropriately included in the proposed Franchise Rule,

66. *Id.*

67. *Id.* at 57,333.

68. *See supra* Part III.B.1.

69. Franchise Rule, 64 Fed. Reg. at 57,333 (proposed alterations in italics).

but modifications are necessary. The definition of “Internet” should conform to the widely accepted technical definition, and the definition of “written” should include language to allow for future technologies that are not currently listed within the definition. Finally, the FTC should add a broad definition for “electronic medium” that would encompass all electronic media, not just the Internet.

C. Proposed Subsection (a): Express Consent of the Franchisee

The remaining sections of this Comment discuss the substantive conditions for electronically supplying the prospective franchisee with franchisor information under proposed section 436.7. Proposed Section 436.7 states in part:

Franchise sellers can furnish disclosures electronically under the following conditions:

(a) The prospective franchisee expressly consents to accept the disclosures in the electronic medium offered by the franchise seller. Prospective franchisees, however, always retain the right to obtain a paper disclosure document from the franchise seller up until the time of the sale.⁷⁰

The FTC “makes clear that a franchisor can furnish disclosures electronically only if it obtains the prospective franchisee’s informed consent.”⁷¹ In constant pursuit of its goal to prevent fraud, the FTC requires informed consent⁷² to prevent franchisors from furnishing disclosure documents in an obscure, unreadable, or undeliverable format.⁷³ “In the same vein, the [FTC] believes that franchisees should have the ability to revoke acceptance of an electronic disclosure document in favor of a paper copy up until the time of the

70. *Id.* at 57,345.

71. *Id.* at 57,316.

72. In a footnote, the FTC gives the following example of informed consent: the FTC “expects a franchisor to disclose in advance the medium used to furnish its disclosures (such as computer disk, CD-ROM, E-mail, or Internet) and any specific applications necessary to view the disclosures (such as Windows 95, or DOS, or a particular Internet browser).” *Id.* at 57,316 n.229.

73. *See id.* at 57,316. The FTC states “that the obligation to furnish disclosures would be a hollow one if franchisors could force prospective franchisees to receive disclosures in an electronic format that they cannot actually receive or read.” *Id.*

sale.”⁷⁴ The FTC believes such a requirement will not likely impose significant cost or time burdens on franchisors.⁷⁵

1. Franchisors' and franchisees' concerns

Concerns pertaining to this subsection are divided into two parts: first, whether the FTC should require a franchisee's consent to electronically receive disclosure documents; and second, whether the FTC should alter the prescribed length of time that a franchisee has to demand a paper copy of the document.

a. Consent. One set of commentators argues that the consent requirement should be omitted.⁷⁶ They suggest that to require a franchisee's consent frustrates the FTC's intention not to “impede franchisors' ability to maximize the use of new technologies in their efforts to comply with the Rule.”⁷⁷ These commentators “envision the day when franchisors will routinely post their UFOCs either on individual websites or through a common electronic platform designed to aggregate such UFOCs for access by the general public.”⁷⁸ In essence, this group contends that a consent requirement will hinder the prospective franchisee's ability to comparison shop among franchisors.

At least one franchise attorney has suggested that the consent requirement is problematic because it is not clear when a prospective franchisee has consented to receiving the disclosure document electronically.⁷⁹ For example, does the act of clicking on a link to the disclosure document constitute consent? What about entering a password supplied by the franchisor accessing the disclosure document?

74. *Id.* at 57,316-17.

75. *See id.*

76. *See* FRANDATA comment, *supra* note 25; Letter from Kenneth S. Kaplan, Assistant General Counsel, AFC Enterprises, to Secretary, Federal Trade Commission (Dec. 20, 1999) (available at <http://www.ftc.gov/bcp/rulemaking/franchise/comments/comment030.htm>) [hereinafter AFC comment]; Letter from Morton Aronson, Neil Simon, and David Kaufmann, on behalf of the National Franchise Council, to Donald Clark, Secretary, Federal Trade Commission (Dec. 21, 1999) (available at <http://www.ftc.gov/bcp/rulemaking/franchise/comments/comment012.pdf>) [hereinafter NFC comment].

77. FRANDATA comment, *supra* note 25, at 5 (quoting Franchise Rule, 64 Fed. Reg. 57,294); *see also* NFC comment, *supra* note 76.

78. FRANDATA comment, *supra* note 25, at 5; *see also* NFC comment, *supra* note 76.

79. *See* Telephone Interview with Neil A. Simon, Executive Director, National Franchise Council (Nov. 2, 1999) [hereinafter Simon interview]. Franchise attorney Howard Bundy has also characterized the consent requirement as ambiguous. Telephone Interview with Howard Bundy, Franchise Attorney (Nov. 19, 1999) [hereinafter Bundy interview].

The FTC does not define consent or classify actions that establish consent.

However, many commentators firmly believe the FTC should not attempt to define consent.⁸⁰ These commentators point out that it is the franchisor's burden to prove that the franchisee consented to receiving the disclosure documents electronically and that failure to meet this burden demonstrates the franchisor's failure to comply with the Rule.⁸¹ They further suggest that a future franchisee can manifest consent in many ways: via e-mail, voice mail, a signed receipt form, or even a check mark on a box transmitted via the Internet.⁸² These commentators contend that, because of the ever-changing technological advances, this requirement should be kept boundless so as to encompass future methods that will confirm that a prospective franchisee consented to receiving a franchisor's disclosure document.⁸³

b. Time period for receipt of paper copy. With respect to the requirement that the franchisee "retain the right to obtain a paper disclosure document from the franchise seller up until the time of sale,"⁸⁴ at least one commentator has proposed that the FTC extend the period of time to "the later of the expiration of the initial franchise term or the termination of the franchise relationship."⁸⁵ The commentator suggests that such a requirement will impose no significant cost or inconvenience on the franchisor, which retains most disclosure documents in the regular course of its business.⁸⁶

2. Recommendation

a. Consent. The FTC should make no effort to further define consent. As stated above by respected members of the franchise community, changing technologies would likely make the definition

80. See Telephone Interview with Lee J. Plave, Attorney, Piper Marbury Rudnick & Wolfe (Nov. 3, 1999) [hereinafter Plave interview]; Telephone Interview with Dennis Wiczorek, Attorney, Piper Marbury Rudnick & Wolfe (Nov. 4, 1999) [hereinafter Wiczorek interview]; Bundy interview, *supra* note 79.

81. See Plave interview, *supra* note 80.

82. See *id.*; Wiczorek interview, *supra* note 80.

83. See Bundy interview, *supra* note 79.

84. Franchise Rule, 64 Fed. Reg. 57,294, 57,316-17 (1999) (to be codified at 16 C.F.R. pt. 436) (proposed Oct. 22, 1999).

85. Bundy comment, *supra* note 55, at 16.

86. See *id.*

obsolete, or at the minimum, susceptible to change in the near future. With emerging technologies, a franchisor can prove consent in many ways; thus, to limit the scope of actions that constitute consent undermines the FTC's goal to allow franchisors to use new technologies.

Although certain commentators persuasively argue against the requirement of consent altogether,⁸⁷ the FTC should not eliminate the consent requirement in its entirety. As the FTC points out, a prospective franchisee's consent does protect it from potential fraud and receiving documents that it cannot otherwise read. However, the FTC should delete the requirement that the consent be "express." The term "express consent" signifies that the prospective franchisee's consent must be affirmatively given in a form similar to the receipt form already required by the Rule. Although the franchisor already carries the burden of proving that the prospective franchisee consented to receiving the disclosure document, the proposed language "express consent" heightens this burden. In essence, franchisors may resort to documenting express consent by requiring prospective franchisees to sign a consent form. This clearly frustrates the purpose of allowing electronic disclosure and contradicts the FTC's wish to "not . . . impede franchisors' ability to maximize the use of new technologies in their efforts to comply with the Rule."⁸⁸ Although it may not seem that requiring express consent would unduly burden a franchisor, the number of prospective franchisees with which a franchisor conducts business does increase the administrative burden of ensuring those franchisees that received electronic disclosure "expressly" consented.

In addition, eliminating the word "express" from the consent requirement would not impair the FTC's overall purpose of protecting consumers. In fact, the consent requirement remains. A prospective franchisee would not consent to accept a document it cannot access because of incompatible software or other problems. Conversely, a prospective franchisee *can* consent to accept a document it *can* access because it has compatible software. Yet in the latter situation, the proposed franchisee may not have "expressly" consented accord-

87. See FRANDATA comment, *supra* note 25; AFC comment, *supra* note 76; NFC comment, *supra* note 76.

88. FRANDATA comment, *supra* note 25, at 5 (quoting Franchise Rule, 64 Fed. Reg. 57,294); *see also* NFC comment, *supra* note 76.

ing to the current proposed rule. However, in the latter situation, there is clearly consent, and the franchisor's records are likely to prove it. Requiring express consent only imposes additional burdens on the franchisor.

Furthermore, removing the term "express" aids in resolving the concerns of those who wish to remove the consent requirement altogether. These commentators "envision the day when franchisors will routinely post their UFOCs either on individual websites or through a common electronic platform."⁸⁹ By downloading a document posted on a Web site or by similar means, the franchisee's consent requirement would be fulfilled, and therefore the franchisor will have complied with the Rule without undue burden. However, as advocates for removing the consent requirement argue, the franchisor may not have complied with the proposed "express consent" requirement, and thus some additional affirmative response from the proposed franchisee may be necessary. Removing the "express" requirement provides adequate protection to consumers while minimizing the franchisor's additional burdens.

b. Time period for receipt of paper copy. The FTC's proposed provision granting a prospective franchisee the right to obtain a paper disclosure document until the time of sale is fair and should remain unchanged. Although at least one commentator proposed that the time period be extended until "the later of the expiration of the initial franchise term or the termination of the franchise relationship[,]"⁹⁰ the FTC's proposed provision allows a prospective franchisee to request a disclosure document during the time period that a franchisee is most likely to use and study the document. During the pre-sale time period, the franchisee should know whether he or she requires a paper version to supplement or replace the electronic disclosure. The commentator contends that allowing a franchisee to request a paper version until the later of the expiration of the franchise term or termination of the relationship bestows only a minor burden on the franchisor. On the contrary, given the amount of possible franchisees and franchise disclosure documents, the labor costs alone associated with searching for disclosure documents that may be several years old could become burdensome for franchisors responding to multiple requests. Even though the documents may be neatly

89. FRANDATA comment, *supra* note 25, at 5; *see also* NFC comment, *supra* note 76.

90. Bundy comment, *supra* note 55, at 16.

stored on computer disks or other similar media, franchisors must determine which document was disclosed to the requesting franchisee, and this may not be a quick and easy task. The prospective franchisee has ample time to request a paper version of the disclosure document before the sale of the franchise.

Furthermore, the disclosure document is a reflection of a franchise company at the time of disclosure. Requiring franchisors to make available their disclosure documents to franchisees after the sale of franchises could cause confusion for both franchisors and franchisees. Franchisors could mistakenly produce an incorrect version of the disclosure document. Similarly, franchisees could request an older version of the document that the franchisee mistakenly believes to be representative of the franchisor's current company profile. In either of these two scenarios, confusion and possible consumer fraud exists. The prudent choice is to allow the franchisee to request a paper copy of the disclosure document until the time of sale, since after the sale the disclosure document has served its primary purpose and will likely change with time.

In sum, subsection (a) of section 436.7 should read as follows:

The prospective franchisee consents to accept the disclosures in the electronic medium offered by the franchise seller. Prospective franchisees, however, always retain the right to obtain a paper disclosure document from the franchise seller up until the time of the sale.

D. Proposed Subsection (b): The Paper Summary Document

The next subsection, proposed subsection 436.7(b), requires the franchisor furnishing its disclosure document electronically to provide prospective franchisees with a paper summary of the disclosure document. The proposed subsection states:

The franchise seller simultaneously furnishes the prospective franchisee with a paper summary document containing only the following three items from the franchisor's disclosure document: (1) The cover page; (2) The table of contents; and (3) Two copies of the franchisor's Item 23 Receipt, with instructions to acknowledge receipt through a signature.⁹¹

91. Franchise Rule, 64 Fed. Reg. at 57,345.

The FTC requires the paper summary document to fulfill “two anti-fraud purposes: (1) [a]dvance notice of the importance of the information being disclosed; and (2) proof of receipt.”⁹²

As to notice, the FTC wishes to place the prospective franchisee on notice that the Franchise Rule exists and that the franchisor must provide certain disclosures to the proposed franchisee.⁹³ Currently, the Rule requires the franchisor to provide a cover page that notifies the potential franchisee that the disclosure document contains important information and “cautionary messages,” as well a table of contents outlining the major items included in the disclosure document.⁹⁴ “The [FTC] believes that a prospective franchisee is more likely to read the disclosures if he or she knows that it contains information such as the franchisor’s litigation history (Item 3), financial performance information (Item 19) and statistics on franchisees in the system (Item 20).”⁹⁵

The retention of the paper summary requirement in propose rule 436.7 suggests that the FTC is also concerned with the fundamental difference between paper and electronic disclosure. To access an electronic disclosure document, either by disk or via the Internet, the franchisee must somehow—usually by some affirmative action of the prospective franchisee—retrieve the document on screen, whereas a paper document conveys information on its face. The FTC is troubled by this inherent difference because of potential fraud to the franchisee.⁹⁶ For example, the FTC worries about franchisors supplying potential franchisees with unmarked computer disks or compact disks that require the prospective franchisee to go through affirmative steps to view the document.⁹⁷ “In such an instance, the prospect may fail to read the disclosures contained on the disk, or, worse, might discard the disk, because nothing draws his or her attention to the importance of the information contained on the disk.”⁹⁸ To remedy this possible scenario, the FTC argues that the paper summary document will signal the franchisee that the franchisor must provide

92. *Id.* at 57,317.

93. *See id.*

94. *See id.*; *see also* 16 C.F.R. § 436 (1999).

95. Franchise Rule, 64 Fed. Reg. at 57,317.

96. *See id.*

97. *See id.*

98. *Id.*

a disclosure document containing pertinent information about the franchisor without requiring the franchisee to take further action.⁹⁹

The second purpose subsection (b) serves is to provide proof that the electronic disclosure document was delivered to and received by the prospective franchisee.¹⁰⁰ To support its contention, the FTC quotes from a prior notice:

Because there may be technological difficulties that could impede the electronic delivery of information, it may be necessary for industry members to confirm that the recipient in fact received the information. Most facsimile machines routinely confirm when the facsimile has been successfully transmitted. Senders, for example, might require recipients to confirm receipt by return e-mail or verify in some manner the recipients' access to information posted on the Web site.¹⁰¹

The FTC concedes that a potential franchisee can confirm receipt either electronically or by paper because the proposed definition of "signature" permits either method.¹⁰² Additionally, the FTC expressly rejects the proposition that a franchisor can verify receipt of the electronic disclosure document by means of embedding codes in the document or by any other method electronically verifying receipt of the document.¹⁰³

1. Franchisors' and franchisees' concerns

Franchisors and franchisees do not unanimously support the FTC's proposed subsection 436.7(b). Although some commentators have expressly applauded the FTC's proposed paper summary document requirement,¹⁰⁴ several others prefer alterations to the subsection.¹⁰⁵

99. *See id.*

100. *See id.*

101. *Id.* (quoting Interpretation of Rules and Guides for Electronic Media; Request for Comment, 63 Fed. Reg. 25,001 (1998)).

102. *See id.* at 57,317-18.

103. *See id.* at 57,318.

104. *See* Letter from L. Seth Stadfeld, Attorney, to Secretary, Federal Trade Commission (Dec. 21, 1999) (available at <<http://www.ftc.gov/bcp/rulemaking/franchise/comments/comment023.htm>>) [hereinafter Stadfeld comment]; Bundy interview, *supra* note 79; Telephone Interview with Andrew Seldon, Franchise Attorney (Oct. 28, 1999); Simon interview, *supra* note 79.

105. *See* Letter from Don DeBolt and Matthew R. Shay, on behalf of the International Franchise Association, to Donald S. Clark, Secretary, Federal Trade Commission (Dec. 21,

The primary argument against requiring a franchisor to supply a paper summary document in addition to electronic disclosures is that it undermines the purpose of electronically disclosing information.¹⁰⁶ “While the concept is sound, . . . further widespread use of electronic communication may make such hard-copy disclosures unnecessary in the near future.”¹⁰⁷ Using similar reasoning, commentators suggest that the FTC allow franchisors to provide the summary document electronically—“either via electronic mail, a website, or facsimile, with the requirement that the Acknowledgement of Receipt *must* be returned via facsimile or mail or in an electronic format containing an acceptable electronic signature.”¹⁰⁸ Other commentators simply suggest that the FTC implement a “mechanism (short of an additional rulemaking) that would permit the FTC to eliminate any paper requirements in the disclosure process as electronic disclosure technology advances permit.”¹⁰⁹ In short, skeptics of subsection (b) are concerned that the provision does not adequately account for current and future technological advances.¹¹⁰

Another concern raised by franchise commentators is the FTC’s use of the word “simultaneously.”¹¹¹ The FTC requires the franchisor to provide the paper summary document when furnishing the franchisee with the electronic disclosure document “simultane-

1999) (available at <<http://www.ftc.gov/bcp/rulemaking/franchise/comments/comment022.htm>>) [hereinafter IFA comment]; Letter from Robert Tingler, Illinois Attorney General’s Office, to Donald S. Clark, Secretary, Federal Trade Commission (Dec. 15, 1999) (available at <<http://www.ftc.gov/bcp/rulemaking/franchise/comments/comment003.htm>>) [hereinafter Illinois AG comment]; Letter from Dennis E. Wiczorek, Attorney, Piper Marbury Rudnick & Wolfe, to Donald S. Clark, Secretary, Federal Trade Commission (Dec. 20, 1999) (available at <<http://www.ftc.gov/bcp/rulemaking/franchise/comments/comment004.htm>>) [hereinafter PMRW comment]; FRANDATA comment, *supra* note 25; NFC comment, *supra* note 76; Plave interview, *supra* note 80.

106. See IFA comment, *supra* note 105; Plave interview, *supra* note 80.

107. IFA comment, *supra* note 105, at 2.

108. FRANDATA comment, *supra* note 25, at 5; see NFC comment, *supra* note 76.

109. IFA comment, *supra* note 105, at 2. See Letter from Ronnie Volkening, Manager, Government Affairs, 7-Eleven, to Donald S. Clark, Secretary, Federal Trade Commission (Dec. 21, 1999) (available at <<http://www.ftc.gov/bcp/rulemaking/franchise/comments/comment010.htm>>) (agreeing with IFA); PMRW comment, *supra* note 105 (suggesting the FTC “[a]llow for interim regulatory review of the need for the paper summary disclosure requirement”).

110. See PMRW comment, *supra* note 105; Plave interview, *supra* note 80; Wiczorek interview, *supra* note 80.

111. See Illinois AG comment, *supra* note 105; PMRW comment, *supra* note 105.

ously.”¹¹² Commentators view this requirement as “impracticable”¹¹³ and ambiguous.¹¹⁴ Read literally, the “simultaneous” provision requires franchisors to furnish the potential franchisee with the paper summary and electronic disclosure *at the same time*. While a franchisor can hand an individual a disk and sheets of paper at the same time, it is not feasible to require a franchisor to provide a paper summary document *at the same time* an individual accesses the electronic disclosure document on the Internet. In the NPR, the FTC does not explain the reason the paper summary document must simultaneously be provided to the franchisee. One commentator suggests that the FTC clarify “[t]he precise obligation of the franchisor and alternatives for compliance.”¹¹⁵ Yet another commentator suggests removal of the word altogether and that the franchisor complies with the Rule if the paper summary document is delivered before the fourteen-day “holding period.”¹¹⁶

2. Recommendation

The FTC should abandon the paper summary document requirement. As indicated by commentators above, the summary document provision is *presently* “sensible”¹¹⁷ because the majority of franchisors are accustomed to paper disclosures and the transition to electronic format will take time. With decreased costs and increased convenience, however, franchisors will make the transition. And franchisees will welcome the change. When that time comes, the paper summary requirement will only cause franchisors additional expense and bother, and prospective franchisees will be accustomed to electronic disclosure and thus have little to no use for the paper summary. Furthermore, technological advancements will likely create methods to better protect potential franchisees from fraudulent sellers such as improvements in anti-virus and similar software programs.

112. See Franchise Rule, 64 Fed. Reg. 57,294, 57,345 (1999) (to be codified at 16 C.F.R. pt. 436) (proposed Oct. 22, 1999).

113. PMRW comment, *supra* note 105.

114. See Illinois AG comment, *supra* note 105.

115. *Id.*

116. See PMRW comment, *supra* note 105. Proposed section 436.2(a)(b) states that the franchisor must provide the disclosure document to the potential franchisee “at least 14 days before the prospective franchisee signs a binding agreement or pays any fee in connection with the proposed franchise sale.” Franchise Rule, 64 Fed. Reg. at 57,333.

117. FRANDATA comment, *supra* note 25, at 5; see NFC comment, *supra* note 76.

For example, the requirement that the summary document be “paper” *currently* serves a purpose. It does not, however, adequately cover future progress. For reasons stated below, the FTC should abandon the requirement of a paper summary document and modify the Item 23 receipt form. In the alternative, the FTC should remove the word “simultaneously” and provide for future regulatory review.

The FTC should abandon the paper summary document requirement because it appears to require a second receipt form—one that adds signature instructions to the Item 23 form¹¹⁸—that can mislead potential franchisees. Additionally, prospective franchisees consenting to electronic disclosure will need to open the disclosure document to access the Item 23 receipt form. Providing a similar form in paper format creates the possibility that the prospective franchisee will sign and return the paper form without examining the remaining paper summary or electronic disclosure document. Furthermore, the FTC’s goals of notice and receipt are adequately achieved with the return of the Item 23 receipt form.

As explained in the NPR, the FTC’s focus on this provision is to purvey notice of the important information contained in the disclosure document to the potential franchisee and to provide proof of receipt.¹¹⁹ The latter purpose of the provision is fulfilled when a potential franchisee returns the receipt form, whether the form was attached to the summary document or to the disclosure document. By returning the receipt form to the franchisor, the prospective franchisee provides proof of receipt. If the franchisor does not receive a “signed” receipt form from the franchisee, it is the franchisor’s responsibility to ensure that the prospective franchisee receives the disclosure document and signs the receipt form. In subsection (b), the FTC requires that two copies of the Item 23 receipt form be included in the summary document with instructions for acknowledging a receipt through a signature, whether the signature be written or electronic as defined by the proposed rule.¹²⁰ The FTC explains in the proposed provision involving the Item 23 receipt form (proposed section 436.5(w)) that the franchisor *may* provide instructions for returning the receipt (such as e-mail address or facsimile telephone

118. Item 23 of the Franchise Rule is the receipt form that a prospective franchisee must return to the franchisor acknowledging receipt of the franchisor’s disclosure document.

119. *See* Franchise Rule, 64 Fed. Reg. at 57,317.

120. *See id.* at 57,345.

number).¹²¹ In effect, the FTC appears to create two slightly different receipt forms—one that the franchisor provides with the disclosure document and one that the franchisor provides with the summary document. The latter receipt form is the Item 23 receipt form with additional “instructions to acknowledge receipt through a signature.”¹²²

There should only be one receipt form—the Item 23 receipt form acknowledging receipt of the disclosure document not the summary document. To avoid any confusion, the FTC should modify the Item 23 receipt form to require instructions for returning the receipt form if the franchisor is utilizing electronic media to provide disclosure documents. Furthermore, the FTC should abandon its requirement that copies of the Item 23 receipt form be delivered in paper form. A potential franchisee may simply sign the paper receipt form and send it to the franchisor without even opening the file containing the entire electronic disclosure document. Excluding it in paper form requires the franchisee to open the electronic disclosure document and, at the very minimum, scroll or link to Item 23 to fill out the form. When the file is opened, the franchisee will be welcomed with the warning-filled cover page. Recalling that the burden of proof lies on the franchisor to establish that the franchisee received the disclosure document, the franchisor will ensure that it has some proof of receipt.

The FTC should relinquish the remaining summary document requirement. When a franchisee opens an electronic file, whether it is on the Internet (in the situation where the franchisor provides the potential franchisee with a Web address) or via computer disk, the first screen is the cover page, which contains the precautionary statements required by the FTC. The franchisee would see, in the first few screens, the same information provided in the summary document. Thus, the FTC’s concern that the franchisee has notice of the important information contained in the disclosure document is satisfied.¹²³ The franchisor must have a copy of the Item 23 receipt

121. *See id.* at 57,344-45.

122. *Id.* at 57,345.

123. Other mechanisms can be added to the electronic file to further ensure that notice is given to the prospective franchisee. For example, in its comment, FRANDATA explains that “pop-up windows” could easily be programmed into the electronic delivery system forcing the prospective franchisee to view the contents of that window. Although FRANDATA discusses these windows in the context of the summary document, these windows could also be used to

form¹²⁴ before the sale of the franchise and thus the franchisee must open the file and, at the very least, scroll or link to the receipt form. Such action is similar to skimming the three documents comprising the paper summary document. Thus, abandoning the paper summary document requirement does not disrupt the FTC's notice and receipt purposes, eliminates need to revisit this issue with acceptance of current and future technological advances, and avoids frustrating the benefits gained by using electronic disclosure documents.¹²⁵ Thus, the FTC should: (1) exclude proposed section 436.7(b); and (2) modify proposed section 436.5(w)(1)(viii) to state:

Franchisors must include any specific instructions for returning the receipt (e.g., street address, E-mail address, facsimile telephone number) if the franchisor electronically furnishes the disclosure document to the prospective franchisee.

Alternatively, if the FTC elects to retain the paper summary document, the FTC should remove the word "simultaneously" because, read literally, it is impracticable to deliver electronic disclosure documents and paper summary documents at the same time. As suggested by a franchise commentator above,¹²⁶ the FTC should require that the prospective franchisee receive the paper summary document prior to the fourteen-day holding period. Additionally, if proposed

display the cover page and/or table of contents. *See* FRANDATA comment, *supra* note 25.

Furthermore, computer disks and compact disks themselves containing the disclosure document can be labeled with the proper precautionary messages required by the FTC. *See* Lee J. Plave, *Technology and Franchising*, A.B.A. Forum on Franchising 36 (1999) (unpublished, on file with author).

124. *See* Franchise Rule, 64 Fed. Reg. at 57,344-45. Proposed section 436.5(w)(2) requires that franchisors receive a signed copy of the receipt at least five days before any money exchanges or any agreement is signed. *See id.*

125. Some franchise commentators suggested retaining the summary document requirement but allowing franchisors to provide the summary document electronically. Because the summary document is no more than excerpts from the disclosure document, summary document disclosure via electronic means resolves neither the FTC's concerns nor the ambiguities addressed above. The three documents that comprise the summary document are the first two portions of the disclosure document (the cover page and the table of contents) plus the receipt form. Delivering the summary document electronically is essentially no different, except the file utilizes less storage space than electronically delivering the entire disclosure document. Instead, the FTC should eliminate the summary document requirement rather than allow electronic delivery of the summary document. Otherwise, the franchisor would send portions of the disclosure document in duplicate using the same method.

126. *See* PMRW comment, *supra* note 105.

section 436.7(b) is enacted, the FTC should provide language reserving its right to revisit and modify the provision.

E. Proposed Subsection (c): Print, Download, or Preservation Capability

Proposed section 436.7(c) states:

The electronic version of the franchisor's disclosure document must be capable of being printed, downloaded onto computer disk, or otherwise preserved by a prospective franchisee as one single document.¹²⁷

The FTC adds this requirement to the proposed rule because it believes a franchisee should have the ability to preserve a copy of the disclosure document for future reference.¹²⁸ "This requirement is particularly important with respect to disclosures disseminated via the Web (which are often transitory), especially if the franchisor does not maintain an online archive of its disclosure documents."¹²⁹

1. Franchisors' and franchisees' concerns

Few comments concentrated on this proposed subsection. One commentator, however, believes that the disclosure document should be capable of being "permanently" preserved by the prospective franchisee.¹³⁰ "The [FTC] should not leave open the possibility that the franchise seller or franchisor might cause a bug or virus to destroy the record on the franchisee's computer or make it inaccessible the day after the sale."¹³¹

2. Recommendation

Proposed subsection (c) should remain unaltered. Although the above commentator's concern with unscrupulous franchise sellers planting bugs or viruses in the disclosure documents to destroy them on franchisees' computers is sound, the current proposed rule adequately safeguards against such activity. For example, if a franchisor infected the disclosure document with a virus that would destroy the

127. Franchise Rule, 64 Fed. Reg. at 57,345.

128. *See id.* at 57,318.

129. *Id.*

130. *See Bundy comment, supra* note 55.

131. *Id.* at 16.

document after it is downloaded by the potential franchisee, then the franchisor would not comply with the Rule because the document is not capable of “preservation” by the potential franchisee. To “preserve” is “to keep safe from injury, harm, or destruction [and to] maintain.”¹³² Following this and similar definitions of the word “preserve,” a document that is purposefully infected by a virus is not capable of being preserved, since, by its nature, it is not capable of being kept safe from injury, harm, or destruction. Furthermore, the proposed rule requires that the document only be accessible *until* the time of sale.¹³³ However, if the franchisor complies with the rule, the franchisee will have the ability to view either a printed or electronic copy if the franchisee desired to print or download the file. It is not the franchisor’s burden to ensure the franchisee actually preserves a copy; it is only the franchisor’s burden to ensure the electronic version is capable of being preserved as a single document.

Moreover, adding the word “permanently” to proposed subsection (c) casts a burden upon the franchisor to ensure that the electronic document can be permanently kept safe from harm or danger. This is not a practical burden, however, since franchisees’ disks, computers, and the like may deteriorate, ruin, or accidentally be destroyed at no fault of the franchisor. Thus, the franchisor cannot ensure that electronic disclosure is “permanently” capable of being preserved. Furthermore, if a franchisor makes available a downloadable file until the time of sale and subsequently removes the file after the sale is completed, the file is no longer “permanently” capable of being preserved, even though it was until the time of sale. Therefore, adding the “permanently” requirement directly contradicts proposed subsection (f).

In sum, proposed subsection (c) both adequately serves the FTC purpose and resolves the commentator’s concerns. The subsection should remain unchanged.

F. Proposed Subsection (d): Single, Self-contained Document

To ensure that potential franchisees are examining a complete disclosure document, without having to undergo any affirmative steps to access other sections of the disclosure document, the FTC proposes the following provision:

132. WEBSTER’S SEVENTH NEW COLLEGIATE DICTIONARY 673 (7th ed. 1972).

133. See Franchise Rule, 64 Fed. Reg. at 57,345 (referring to proposed section 436.7(f)).

The electronic version of the franchisor's disclosure document must be a self-contained document that is the functional equivalent of a paper disclosure document. A prospective franchisee must be able to read each part of the disclosure document, including attachments, without having to take any affirmative action other than scrolling through the document.¹³⁴

The FTC does not want the electronic file to necessitate any affirmative action on the part of the franchisee to locate sections of the disclosure document.¹³⁵ Nor does the FTC view favorably a franchisee having to surf an entire Web site to find certain sections.¹³⁶ Linking documents to one another is not sufficient if a franchisee only downloads and preserves one of the documents.¹³⁷ "In short, any impediment to the prospect's ability to review all portions of a disclosure document online or to preserve the text as a single document would render the document an ineffective communication."¹³⁸

1. Franchisors' and franchisees' concerns

The principal concern arising from this subsection is whether any and all exhibits, such as the franchise agreement, are part of the "single document" requirement. One commentator suggests adding the word "exhibits" to the subsection to clarify that the electronic disclosure document "must contain everything from the cover page through the financial statements, copies of contracts, lists of franchisees, lists of state regulators and registered agents, state specific addenda, and the receipt."¹³⁹

2. Recommendation

The FTC should include "exhibits" in proposed subsection (d) to further clarify that all attachments and exhibits must be in a single, self-contained document. The significant problem, however, arising from including *all* attachments and exhibits in the same single document as the disclosure document is the vast amount of data in one file. Nonetheless, to serve the FTC's well reasoned purpose for

134. *Id.*

135. *See id.* at 57,318.

136. *See id.*

137. *See id.*

138. *Id.*

139. Bundy comment, *supra* note 55, at 16.

this subsection, all the information relating to the disclosure document should be downloadable in a single file to avoid leaving an important document unseen or unpreserved. Fortunately, the FTC allows internal links, which will immensely assist the franchisee in navigating through the document and various attachments. The present state of this subsection may require the FTC's attention again in the future as methods to join or automatically download multiple files with cross-links surface and become prevalent. For the time being, however, proposed subsection (d) should read as follows, with changes in italics:

The electronic version of the franchisor's disclosure document must be a self-contained document that is the functional equivalent of a paper disclosure document. A prospective franchisee must be able to read each part of the disclosure document, including *all exhibits and* attachments, without having to take any affirmative action other than scrolling through the document.¹⁴⁰

G. Proposed Subsection (e): Scroll Bars, Internal Links, and Search Features

The next subsection, proposed subsection (e), provides:

For the sole purpose of enhancing the prospective franchisee's ability to maneuver through the electronic version of the disclosure document, the franchisor may include scroll bars, internal links, and search features. All other features (e.g., multimedia tools such as audio, video, animation, or pop-up screens) are prohibited.¹⁴¹

This provision narrows the use of special features in electronic disclosures to navigation tools within the document itself. Acknowledging the many features that accompany electronic media, the FTC attempts to limit the use of graphics, animation, and the like to "call attention to favorable portions of . . . disclosure document[s] or to distract prospects from damaging disclosures."¹⁴² Navigable features, such as internal links, search tools, and scroll bars, "are the functional equivalent of leafing through a hard-copy document."¹⁴³

140. Franchise Rule, 64 Fed. Reg. at 57,345 (proposed alterations in italics).

141. *Id.*

142. *Id.* at 57,318.

143. *Id.*

1. Franchisors' and franchisees' concerns

Not surprisingly, the franchisors and franchisees applaud the permitted use of internal links, scroll bars, and search functions.¹⁴⁴ Without these tools, potential franchisees would likely avoid electronic disclosure documents since these long single, self-contained disclosure documents would simply be too difficult and inconvenient to decipher. One commentator requests the FTC to further define “internal links” to limit the types of internal links that the franchisor can include.¹⁴⁵ The commentator’s goal is to create a more uniform look to disclosure documents online, so as to negate bias towards better navigable Web sites when consumers are franchise shopping.¹⁴⁶ Still another commentator requests the express prohibition of external links.¹⁴⁷ The principal debate arises, however, with the prohibition of multimedia tools.

Some commentators agree that animation, audio, video, or pop-up screens could be used in the disclosure document to distract franchisees from negative disclosures about the franchisor.¹⁴⁸ These commentators support the prohibition on such multimedia tools,¹⁴⁹ but at least one commentator suggests that this prohibition is “overly broad” and that “there are categories of [such] features which may add to the offering circular in a way that assists a prospective franchisee in reading the document.”¹⁵⁰ Furthermore, the proposal does not prohibit franchisors from providing and emphasizing the importance of a *separate* document containing such features.¹⁵¹

144. See FRANDATA comment, *supra* note 25; NFC comment, *supra* note 76; Plave interview, *supra* note 80; Wieczorek interview, *supra* note 80.

145. See FRANDATA comment, *supra* note 25. For example, “FRANDATA proposes simple links to the 23 items found in the disclosure document, as well as links from the UFOC to any referenced section of any attached agreement.” *Id.* at 4.

146. See *id.* FRANDATA believes that a consumer, while comparison shopping for franchises, viewing a disclosure document from one franchisor that has a superior internal link system or search feature would assume all documents should have identical features and negatively view any other franchisor without identical features. See *id.*

147. See Bundy comment, *supra* note 55. Several commentators agree with the prohibition of external links but do not require express prohibition in the proposed rule. Plave interview, *supra* note 80; Wieczorek interview, *supra* note 80.

148. See FRANDATA comment, *supra* note 25; NFC comment, *supra* note 76.

149. See FRANDATA comment, *supra* note 25; NFC comment, *supra* note 76.

150. Letter from Andrew P. Loewinger, Buchanan Ingersoll, to Secretary, Federal Trade Commission (Dec. 22, 1999) (available at <<http://www.ftc.gov/bcp/rulemaking/franchise/comments/comment028.htm>>) [hereinafter Buchanan Ingersoll comment].

151. See *id.*

2. *Recommendation*

The FTC should add language expressly prohibiting external links but otherwise leave this proposed subsection unaltered. By allowing only links that are internal, the FTC impliedly prohibits external links. However, to clarify its position, especially since external links would violate the single document proposed provisions, the FTC should specifically include language prohibiting external links in this proposed subsection.

The FTC should not, however, further define internal links. Even though consumers could be confused by the lack of uniformity in format among various electronic disclosures, the navigational tools enumerated by the FTC are specific enough to cause only negligible differences between sites. It is possible for one franchisor to install a more useful search function than another; however, consumers, especially those using the Web to franchise shop, are likely to understand that Web sites vary and some may simply be better than others. However, the information provided on the Web site is identical in format (Items 1 through 23 as required by the FTC); thus, the amount of links and their location throughout the document are minor concerns. The most important aspect of this provision is to allow a user to maneuver through the document. The tools prescribed by the FTC carry out this function.

The prohibition of multimedia tools is necessary to limit any tainting of disclosure documents. The disclosure document is a single, self-contained document, and, by itself, should contain no "frills" or multimedia features that would distract the franchisee in any way. Such activity would constitute advertising and lessen the significance of the disclosure document. Although it is accurate that the proposed rule does not prohibit another Web page or file on the same disk from using such multimedia tools, the requirement that the electronic disclosure document be a single, self-contained document containing no external links distinguishes the disclosure document from other advertising files or pages. Thus, the significance of the disclosure document, albeit in simple format, stands apart from advertising or similar files or media.

In sum, proposed section 436.7(e) should read as follow, with additions in italics:

For the sole purpose of enhancing the prospective franchisee's ability to maneuver through the electronic version of the disclosure

document, the franchisor may include scroll bars, internal links, and search features. All other features (e.g., *external links and* multimedia tools such as audio, video, animation, or pop-up screens) are prohibited.¹⁵²

H. Proposed Subsection (f): Accessibility

Another subsection pertaining to electronic disclosures is proposed section 436.7(f), which involves accessibility of the disclosure document. It states:

The electronic version of the franchisor's disclosure document must remain accessible at least until the time of the sale. An electronic version will still be deemed accessible if technological failures occur that are beyond the franchisor's reasonable control. Further, an electronic version on the Internet will be deemed accessible if it is updated and replaced with a more current version.¹⁵³

This provision can in effect be broken down into three parts: first, accessibility until time of sale; second, accessibility if technological failures are beyond franchisor's control; and third, accessibility if an Internet version is updated and replaced by more current versions.¹⁵⁴

As to accessibility until the time of sale, the FTC is concerned with providing franchisees the opportunity to review the disclosure document at will before the franchise sale occurs. Requiring accessibility until the time of sale prevents franchisors from ceasing use of their Web sites before the sale of a franchise.¹⁵⁵

The second aspect of subsection (f), accessibility in the case of technological failures, is included because "any obligation on the franchisor's part to ensure that electronic documents remain accessible should be limited."¹⁵⁶ Specifically, the FTC believes that potential franchisees' computer or system failures do not deem the electronic document inaccessible because the franchisor does not have reasonable control over the potential franchisees' systems.¹⁵⁷ Conversely, if

152. Franchise Rule, 64 Fed. Reg. 57,294, 57,345 (1999) (to be codified at 16 C.F.R. pt. 436) (proposed Oct. 22, 1999) (proposed alterations in italics).

153. *Id.*

154. *See id.* at 57,318.

155. *See id.*

156. *Id.*

157. *See id.*

the franchisor has reasonable control over the technological failure, the provision clearly implies that the disclosure document is deemed inaccessible and the franchisor is not in compliance with the Rule.

Finally, the third part, accessibility of updated disclosure document versions on the Internet, is included because of the FTC's requirement that franchisors periodically update their disclosure documents.¹⁵⁸ "A requirement that disclosures remain accessible indefinitely arguably may result in franchisors having to post multiple versions of its disclosures on the Internet to ensure that each prospective franchisee has continued access to his or her particular version."¹⁵⁹ The cost and burden of such a requirement outweighs any benefit to franchisees.¹⁶⁰

1. Franchisors' and franchisees' concerns

One commentator proposes that the FTC modify the proposed provision in the following manner:

- (1) "require that the Franchise Disclosure Document remain available in the *same electronic communication medium* at least until the time of the sale";¹⁶¹
- (2) require that the "franchisor . . . assure that, notwithstanding [technological] failures, the prospective franchisee *actually* received the Franchise Disclosure Document (in any form) in the time frame required by the Rule";¹⁶² and
- (3) obligate the franchisor to comply with proposed section 436.8 update notification provisions.¹⁶³

2. Recommendation

As currently written, proposed subsection (f) adequately protects the potential franchisee without overburdening franchisors. Each of the above commentator's concerns is discussed in turn.

158. *See id.* (referring to proposed section 436.8 of the Rule).

159. *Id.*

160. *See id.*

161. Bundy comment, *supra* note 55, at 17.

162. *Id.*

163. *See id.*

First, requiring that the disclosure document remain available in the same electronic medium creates a significant conflict for a franchisor in an easily foreseeable situation. If the franchisor furnishes its disclosure document to a potential franchisee on the World Wide Web but subsequently experiences network conflicts of its own requiring the network to shut down for a time period before the sale of the franchise, the franchisor necessarily fails to furnish the document in the same electronic medium. In such a case, the franchisor could easily make available the disclosure document via computer disk or paper copy. Under the language of the current proposed provision, such a favorable action by the franchisor would be in compliance with the Rule. Similarly, a franchisor that decides to send out paper disclosure documents because it abandons its Web site should be deemed compliant with the Rule. If the document must be furnished in the same electronic medium, the franchisor would not adhere to the Rule when sending a paper or disk copy of the disclosure document.

Second, proposed subsection (f) refers to electronic version *accessibility*, not receipt. The provision implies that the prospective franchisee actually received the disclosure document and appears to emphasize accessibility when a franchisee returns for another look at the disclosure document.

Finally, the third part of this provision emphasizes the accessibility of an updated and replaced Internet page and does not negate the notification requirements enumerated in proposed section 436.8. The franchisor must still comply with update notification requirements, but this provision focuses only on defining the “accessibility” of electronic disclosure documents.

In sum, because of this provision’s focus on accessibility, no adjustments to this subsection are required. The most important and logical consideration involving accessibility is simply that if an electronic disclosure is “inaccessible,” there are several alternative methods for receiving a disclosure document.

I. Proposed Subsection (g): Record Retention

The final proposed subsection addresses retention of disclosure documents by franchisors that provide electronic disclosures. It states:

Franchisors furnishing disclosure documents electronically must retain, and make available to the [FTC] upon request, a specimen copy of each materially different version of their electronic disclosure documents for a period of three years.¹⁶⁴

The FTC “advocates a recordkeeping requirement in order to enable a franchisee to be able to show (and ultimately prove) what form of document he or she relied upon.”¹⁶⁵

Although one commentator contends the time period for record retention should be six years,¹⁶⁶ three years is a sufficient time period for retention of pre-sale disclosure documents. To require a longer period of time only results in unnecessary cost and hassle to the franchisor. Furthermore, “only about 24 to 25 percent of [franchise systems] are likely to be here five years from now.”¹⁶⁷ A franchisor should not be required to retain documents for more than three years if the franchisor is no longer in business after that time period. Thus, this proposed provision should remain unaltered.

IV. CONCLUSION

The FTC’s initiative to allow electronic franchise disclosure is laudable. An additional definition of “electronic medium” and a technical definition of “Internet” would clarify the terms used within proposed section 436.7. Although much of the subsection should remain as proposed by the FTC, certain modifications are required to ensure that future technological advances will be acceptable means of electronic disclosure. Finally, a franchisee need not “expressly” consent to receive disclosure documents, and the paper summary document requirement should be expunged. The FTC’s proposed regulations, incorporating the above recommendations, will effectively lead pre-sale franchise disclosure into the twenty-first century.

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164. Franchise Rule, 64 Fed. Reg. at 57,345.

165. *Id.* at 57,319 (citation omitted).

166. See Stadfeld comment, *supra* note 104.

167. Franchise Rule, 64 Fed. Reg. at 57,319 (quoting Howard Bundy).

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