Armstrong Teasdale

FTC Issues Guidance to Franchisors Regarding Disclosure of Franchise Territories

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The Federal Trade Commission recently issued new guidance that will affect how franchisors disclose whether they grant exclusive territories to franchisees.

Under the FTC's Franchise Rule, a franchisor is required to divulge to a prospective franchisee whether the franchisee is granted an exclusive territory and, if so, whether there is a minimum territory and how its size will be determined. This disclosure, which is made in Item 12 of the Franchise Disclosure Document, must be accompanied by an explanation of any rights the franchisor retains to offer products or services within the franchisee's territory. If a franchisor does not grant any territory to its franchisees, it must make a specific negative disclosure in Item 12.

Many franchisors that do grant protected or exclusive territories retain for themselves a number of rights to conduct certain activities within the franchisee's area of protection. These retained rights usually include the right to open outlets in "non-traditional venues" such as theme parks, airports, casinos, hotels, military installations, malls, schools, and the like. A franchisor must carefully explain each of these exceptions in Item 12.

In its newly-released guidance, the Commission has explained that when a franchisor does grant to a franchisee a protected territory but reserves the right to locate outlets (whether franchised, company-owned, or affiliate-owned) in non-traditional venues, the franchisor cannot claim in its FDD that it grants an "exclusive" territory. Instead, the company must explain that it does not offer an exclusive territory. The franchisor must also provide a negative disclosure that warns prospective franchisees that they may face competition from other franchisees, outlets that the company owns, or other channels of distribution or competitive brands that the franchisor controls.

The FTC's guidance will directly affect a significant number of franchisors nationwide. Most franchisors that do provide exclusive territories of any size typically will reserve the right to non-traditional venues within those territories. The FTC reasons that "because 'non-traditional venues' entail an outlet physically located in a franchisee's territory," the territory is not actually "exclusive" within the meaning of the Franchise Rule. Because of this, franchisors will be required to make the negative disclosure mandated under the Rule.

In light of the FTC's direction, franchisors that grant areas of protection but reserve rights would also be well-advised to avoid the use of the words "exclusive territory" in describing the area granted to the franchisee. Instead, careful franchise companies will use such terms as "area of protection," "protected territory," or "protected area."