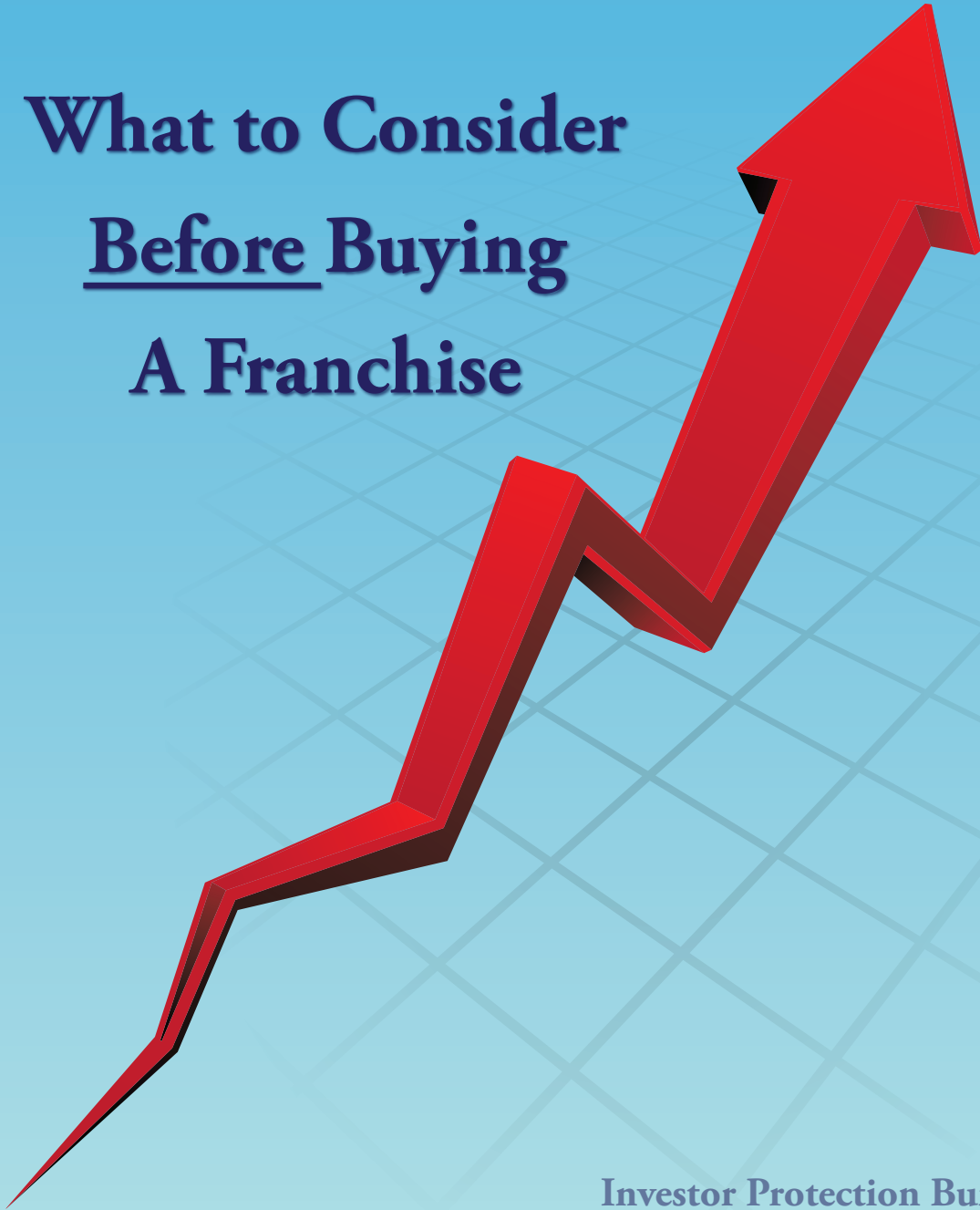


NEW YORK STATE OFFICE
— *of the* —
ATTORNEY GENERAL

**What to Consider
Before Buying
A Franchise**



Investor Protection Bureau

Before Buying a Franchise...

Buying a franchise is a serious investment. If you are considering a franchise purchase, it's very important that you learn as much as you can about the many issues facing you. This booklet is a good step toward becoming an informed investor.

There are certainly many individuals who operate successful franchises using this unique business format. There are also many who have fallen victim to scam artists and ended up losing their life savings. Others did not do enough research or seek professional advice before signing contracts. Without fully understanding the terms of their agreement, they put both their investment and their livelihood at risk.

In putting together this booklet, we have two major goals:

- (1) To assist you in avoiding illegitimate franchises set up by scam artists; and
- (2) To make you better aware of the franchisor-franchisee relationship and the unequal bargaining power that can exist in it.

I hope this booklet will assist you in making a decision as to whether franchising or a particular franchisor is right for you.

Don't Let This Happen to You

The terms of the deal were clear. The franchise agreement spelled it all out clearly: in return for an investment of \$20,000 to \$50,000, franchisees were given a route along which to sell the franchisor's exclusive line of snack and beverage products. The franchisees would order the products from the franchisor and sell them to stores, and keep the profit. They were also advised to buy equipment, rent warehouse space and purchase a truck. However, the products arrived months late and were of poor quality: the potato chips were stale and there were foreign particles in the beverages. Soon after the initial fees were paid, the franchisor closed down his warehouse, stopped answering his phone and disappeared with the franchisees' money.

This case is real. The Attorney General's Office brought an action against the scam artists and achieved a large monetary judgment against the defendants. The victims were normal, everyday people who thought that they were investing in a legitimate franchise business. Tragically, however, they lost their life savings because of a lack of thorough research. They trusted what they were told instead of doing their homework and checking up on each aspect of the franchise. Consulting with an attorney, accountant, or a knowledgeable business professional would have helped purchasers learn about franchising risks. As it turns out, this Afranchise@ was not registered with the state, and the president and owner already had a felony conviction: a scheme to defraud. If the franchisees had known what to consider when buying a franchise, they likely would not have invested.

I. Warning Signs of a Fraud

1. Failure to Disclose All Necessary Documents and Details

The franchisor who will not properly disclose all relevant details to the potential franchisee is probably trying to hide something. The franchise may not be profitable or worse, a scam. Before you sign anything, be sure you learn all of the relevant information, make sure your questions are answered fully and be certain that the details are clear.

2. High-Pressure Sales Tactics

You should never feel pressured to buy a franchise or to make your decision quickly, for any reason. Remember that you are making an investment and you should be cautious with your decision.

3. Claims of Minimal Risk and Promises of Unrealistic Profits

There is a risk associated with buying a new franchise. Even the franchisor with the most successful chain cannot legitimately promise that you will make money. Be wary of any franchisor who guarantees that you will make a lot of money with little risk.

4. Unjustified Start-Up Fees

Initial fees are sometimes very high; and if they seem too high that may be the case. You should know if the initial fees include services or goods that are to be received by the franchisor before the franchise business opens, and if the fees are refundable. Many crooked franchisors have sold franchises and disappeared with the initial franchise fee.

II. The Truth about Legitimate Franchises:

What Every Investor Should Understand

Many franchises are successful because the system creates a certain synergy. Businesses brought together under one trademark can achieve things not possible for individual business people, such as group advertising and buying power. Along with success comes a certain number of failures. There are no guarantees. It is vital that potential franchisees understand that:

Franchises are not guaranteed to make a profit. Even if you own a business which is part of the most successful franchise in the world, your store may lose money, especially in the beginning. Be prepared to have sufficient savings and financial resources to deal with this type of situation.

A franchise is a long-term investment. You will not get rich quick. It may take you several years to develop your business to a point where you have paid off loans and are making the amount of money you anticipated. If your business does not become profitable or you tire of it, you cannot simply close up shop and forget about it. Like it or not, you must continue to work for the full amount of time agreed to in your contract.

Franchisees cannot deviate from the norm under any circumstances. You will be told exactly how to run your business, right down to how to organize your books or where to keep the napkins. Even if you believe that the franchisor's decision is not the best one for your particular store or regional location, you will be required to follow the rules. If you are a natural entrepreneur with a creative mind, who wants to operate your business your own way, franchising is probably not for you.

A franchise requires a very large amount of money. The startup fees may number in the hundreds of thousands of dollars. Make sure you and your family can afford to sustain this kind of loss, should your business fail. There will also be continuous fees for royalties and advertising which will continue for as long as you own the business. They may be quite high and you may not want to pay them after learning the business and doing all the work, but you will be bound to pay them as part of your contract.

You are not guaranteed the right to alternate vending of inventory, product, service or supplies beyond those that are disclosed in the franchise disclosure document. The franchisor may require you to buy everything you need from an approved vendor or group of vendors, even if you know that you could buy the same items elsewhere for significantly less. These vendors often charge more than independent vendors because they give the franchisor a part of the earnings.

The franchisor may be bought out or may go out of business. If the franchisor sells to or merges with a company that does not understand franchising or if it has different goals that allow the system to deteriorate, you may suffer.

III. Tips for Prospective Franchise Purchasers

- 1. Make sure the seller supplies you with an offering prospectus, also known as a franchise disclosure document, approved by the Office of the Attorney General and that you read it carefully.**

Under New York State law you must receive an offering prospectus, also known as a franchise disclosure document (FDD), at least 10 business days before you are asked to sign a contract or pay money to the franchisor. When you receive an FDD you will be asked to sign a receipt for it. Make sure that the date on this receipt is correct and keep a copy for your records. A dishonest franchisor may attempt to satisfy the 10-day rule by back-dating the receipt without your knowledge. The franchisor may also ask you to consent to the back-dating in order to complete the transaction at an earlier date than allowed by law. You should refuse. The 10-day rule is designed to afford you time to thoroughly examine the FDD and make an unhurried decision about whether or not to invest in the franchise. To check if a franchise is registered, call the franchise section of the Office of the New York State Attorney General at (212) 416-8236 or (212) 416-8235 or (212) 416-8637.

- 2. Consult with an attorney, an accountant or other professional with business or financial experience in franchising before making payments or signing documents.**

If you cut corners on professional advice, you may well regret it later. You should seek professional legal and/or accounting advice, before becoming a franchisee, especially from someone familiar with the field of franchising, to help you make an informed decision. An attorney can help you understand the franchise contract, which is part of the FDD. A number of organizations, including the New York State and American Bar Associations and the American Association of Franchisees and Dealers, list attorneys with this experience on their websites. You can find contact information for these groups in the Resources section of this booklet. Ask your attorney to explain complex matters such as royalty payments, advertising fees, copyright infringement, and the effect of contract violations. Choosing a lawyer you are comfortable with and that you can afford may take some investigation, but it is worthwhile. Before seeing an attorney, ask about the cost of the initial consultation.

An accountant can explain the financial statements that are part of the FDD. These statements tell you whether the franchisor is financially strong and whether the franchise is profitable. If the franchisor is financially weak, consider carefully before you buy; the franchisor may be selling franchises to raise cash just to stay in business. The financial statements can also tell you whether the franchisor is devoting sufficient funds to the franchising aspects of the business or keeping most of it as profit. You should not attempt to

extract this important information from the FDD by yourself unless you have considerable background in these matters or in the type of business that you are considering.

Carefully study the estimate of initial expenses contained in the FDD. Franchisors may underestimate these expenses in an effort to make the cost of purchasing seem lower than it really is. If the estimate is too low, you may find yourself with insufficient cash to carry on until the business produces a profit. Relying on the FDD without consulting a professional and hoping that the franchisor has told the truth is setting yourself up for potential fraud. At the end of this booklet, there is a list of associations and government agencies that may be able to help you in your research.

3. The experience of others can be an effective guide to determining how you would do as a franchisee.

The FDD should disclose the names and addresses of individuals currently operating franchises in New York and adjacent states. Contact them and ask them how their franchises are doing. Visit the franchised premises and observe the volume and type of business being done. Pay attention to the number of franchises terminated during the past three years -- an unusually large number may be a telling sign of how the franchisor does business. The FDD should disclose the names and addresses of franchisees that have dropped out of the system within the last year. Contact them to find out why they dropped out. It is important to communicate with every listed franchisee, if this is practical, or a large sample of them, if it is not. The more you talk to, the more you will learn about the franchisor and the chain. (See Section IX for a list of questions to ask franchisees). If a franchisor offers to supply you with a list of selected franchisees to contact; view this with appropriate suspicion. Those on the list may be Ashills@, franchisees being paid by the franchisor to promote the business. Indeed, if the franchisees on the list are far away and not likely to be visited personally, they may not be franchisees at all, just dishonest people on the other end of the telephone.

4. Look for a territorial protection clause in your contract.

Encroachment is one of the most litigated issues in franchising. Whether you are a fast food franchisee who finds another unit has opened up a few blocks away, an ice cream franchisee who sees his product being sold in the corner grocery store or a franchisee who discovers that his franchisor is taking orders over the InternetCall of this can add up to lost profits for a franchisee who has spent years building up a business.

Protected or exclusive territory is the area around the franchisee's business location in which no other branch of the franchise is allowed to open a store.

The extent of the protected territory may be defined by the radius from the outlet's location, the number of residents, households and businesses in the area, the number of people living in the area, zip codes, state or highway boundaries, or some other measure. Sometimes, the franchisee must meet certain sales quotas or performance standards in order to keep the exclusive territory. Before signing the contract, you should determine if the protected territory is large enough to support the business objectives if competing with other branches of the franchise.

The protected territory clause in the original contract will clarify exactly what is and is not considered exclusive territory. Courts often uphold the idea that if there is no specific protected territory clause in the original contract, the franchisee has no legitimate encroachment claim, so make sure you are clear on exactly where your franchisor can and cannot open stores that will send up competing for business with your franchise. Sometimes, the franchisor will make a deal with an existing franchisee. The franchisor will allow a store to open within the exclusive territory and the franchisee will receive a percentage of the profits from the new store. This is called a reverse royalty.

5. You should understand that although you will be the owner of your own business and bear the consequences of its success or failure, you will not be independent.

You will be part of a chain and will be expected to conform to rules designed to assure that the product or service which you deliver is of the same quality as those delivered by the chain's other franchisees. Uniformity is very important to a franchise chain and you will be required to follow the rules, even if you have better ideas of your own. If you are an independently minded person, franchising may not be for you.

6. Be aware of non-compete clauses.

Even after you have relinquished control of your outlet, you should be aware that your contract still survives and it will probably contain a non-compete clause. This section prevents you from owning or operating a competing business within a certain geographical area for a specific time period.

7. Widespread customer recognition of a trade name is the equivalent of goodwill in franchising.

The trade name is the symbol of the franchise chain's quality. Anyone familiar with a trade name has an idea of the quality it represents. The same is true of the name you will be purchasing when you buy a franchise. If the name of a franchise is unfamiliar, you should question whether it's a good investment. Operating your business under a recognizable franchise name may give you

have a head start in the marketplace, but it is no guarantee that you will make a profit. No franchisor can guarantee that your outlet will be profitable.

The performance of the other franchisees in the chain will also affect the quality associated with the name, as will the leadership and imagination of the franchisor itself. If others in the system do a poor job, the ill will which ordinarily attaches to such performance may be transferred to your business. Also, the franchisor's willingness to advertise and to update the product is of key importance. The actions or inactions of a franchisor or other franchisees may ruin a franchise name no matter how hard you work.

Extra caution should be taken when dealing with a new franchisor or one that does not have its trademark federally registered, because in these situations the brand identity of the franchise you have purchased may be at risk. What type of trademark protection has the franchisor sought? Are there any possible conflicts with its marks that could affect you, the franchisee? In the event a problem arises with the franchisor's mark or if another chain acquires the franchise system, does the franchisor have the right to require the franchisee to change its mark?

8. Examine the site selection process outlined in the prospectus, as the location of a franchise is very important.

A poorly selected location may well doom a franchise. Determine what the franchisor will do to help select an appropriate site and whether you will be able to change the site if it proves to be unsatisfactory. Find out if relocation rights are granted to the franchisee in the event of condemnation, lease expiration, or poor business results, or if relocation is determined by the franchisor's then-current policy. Is territorial exclusivity included in the contract? If so, what is the exact nature of the protection? Is it contingent upon performance levels? If the franchisor's participation in the site selection process appears to be perfunctory, or if the franchisor offers no assistance, think twice about buying. If you are purchasing an existing store or route, find out why the previous franchisee is no longer with the company.

9. Training is a distinct advantage of franchising.

It enables the franchise operator to acquire skills that an independent operator might take months or years to develop. If the prospectus does not detail the training, ask about it. Also, ask existing franchise operators about the training they received.

10. Look for franchisee advisory groups and associations.

Both advisory groups and associations are organizations of franchisees, but they differ in their roles. Advisory groups are organized by the franchisor and

are composed of franchisees and franchisor representatives. They help the franchisor make decisions, voice complaints, and form relationships with other franchisees. Franchisee associations, on the other hand, are usually independent of the franchisor. They have their own system of organization, rules and membership requirements. Franchisees pay dues in order to fund the activities of the association. In some cases, an advisory group and an association coexist in the same franchise chain. If your franchise has an association or advisory group, it may imply that the franchisor takes the requests and ideas of the franchisees seriously, and these are often strong franchises. Contact representatives from these groups about whether the franchisors are responsive to their franchisees.

11. Know the franchise seller.

A franchise agreement is only as good as the people behind it. The prospectus gives certain information concerning the employment background of the senior management of the franchisor and their litigation histories. Check this to see if they have been employed in franchising or a business related to the franchise being sold. Examine their litigation history. An excessive number of claims against them may mean that they have not been performing according to their agreements.

The franchisor's experience in selling franchises and managing a franchise chain is important. If the franchisor has little experience in managing a chain of franchises, the guidance, training and other support you receive may be unreliable.

IV. Two Important Questions about Franchising

1. What is a franchise disclosure document (FDD)?

A franchise disclosure document, also known as an offering prospectus, is a legal document furnished to a prospective buyer of a franchise, which contains material--that is, significant and important to a prospective franchisee-- pre-sale disclosure information about a franchise business. The FDD includes over 20 different items of information about the franchise, including the history of the company, required fees and investment costs, information about the franchisor, including any litigation. When you are given the FDD, you must sign and date a statement acknowledging that you received it.

2. What is the regulatory framework governing franchises?

There are three distinct bodies of law governing franchising: federal and state registration and disclosure laws, Afranchise relationship@ laws, and Abusiness opportunity@ laws.

State Franchise Registration and Disclosure Laws

State registration and disclosure laws provide that, unless an exemption is available, no offer or sale of a franchise can take place until the franchisor has registered a FDD with the state in which the sale is occurring, the FDD has been approved and the potential purchaser has received a copy prior to signing any agreements. To be approved, a FDD must honestly and in detail explain all of the material facts of the franchise and the sale. These registration and disclosure laws are looking to prohibit misrepresentation in the offering of franchises to potential buyers and to make sure that these potential buyers have at their disposal all of the necessary information to make an informed decision. Criminal and civil penalties may apply to franchisors who do not fully disclose all of the necessary information or who misrepresent the truth. Both state and federal agencies permit the FDD to largely take the form of the 2008 Franchise Registration and Disclosure Guidelines, promulgated by the North American Securities Administrators Association (NASAA). These are available for downloading at www.nasaa.org.

New York Law

The New York Franchise Sales Act states that before any franchise sales activity can take place in this state, the franchisor is required to submit a FDD for approval to the New York State Department of Law (The Office of the Attorney General). "Sales activity in New York" includes all situations in which the seller lives in New York, the buyer lives in New York, the deal is made in New York, or the store will be located in New York. Should incomplete or questionable material be submitted, the state Attorney General reserves the right to investigate the franchisor and/or the company.

A copy of the FDD must be given to the buyer at least 10 days before signing an agreement. Failure to comply with these requirements could result in an investigation by the Office of the New York State Attorney General, and may also result in a lawsuit.

The Federal Trade Commission Franchise Rule

The FTC Rule states that franchisors must make full pre-sale disclosure in a prospectus, or FDD. However, unlike the New York State law, the FTC Rule does not require that the FDD be approved prior to distribution. Enforcement under the Rule is bolstered by penalties of up to \$10,000 per violation.

Franchise Relationship Laws

A franchise agreement, like any other contract, has a fixed term. Also like any other agreement, a franchise contract may be terminated before it actually expires. Eighteen states and the District of Columbia (but not New York) have enacted laws limiting the ability of the franchisor to terminate the deal. Many states require a just cause for termination. Just cause is defined as the failure of the franchisee to comply with some aspect of the deal as put forth in the contract, as well as the failure of the franchisee to correct, or cure, the problem once it has been pointed out. Other relationship laws address such aspects of the franchise relationship as discriminatory treatment, market protections, ability of franchisees to belong to franchise associations and the minimum advance notice of termination or expiration which must be given to franchisees.

Business Opportunity Laws

Twenty-three states have enacted business opportunity laws. New York is not one of the states that has a business opportunity law. These laws regulate the sale of opportunities to engage in new business ventures, so they often impact franchises. The laws require registration and disclosure in the same manner as state franchise registration laws do and usually also require the posting of some kind of financial security investment. Some states exclude franchise offerings from business opportunity laws because they comply with federal or state franchise regulations, while other states hold franchises to both the business opportunity laws and the state regulations.

V. The Costs of Buying and Owning a Franchise

Make sure you are prepared to make an investment of a large magnitude before you buy. Compare your estimates with the estimates of other franchise chains. Will you get a better deal from a competitor's franchise?

Initial Franchise Fee

The initial franchise fee includes all fees and payments for products and services received from the franchisor before the business opens. The initial franchise fee is usually non-refundable and paid up front. In some cases, it is payable in installments, but the franchisor must disclose the terms of payment in the contract. Sometimes the initial franchise fee is deferred or placed into an escrow account until the franchisor has completely performed all of its obligations to help the franchisee start up the business. This usually indicates that the franchisor is financially weak or that the franchise is newly organized.

Other Fees

These fees are usually explained in the form of a table which clarifies how much money must be paid to whom and when such payments are due. This may include, but is not limited to, fees for royalties, advertising, transfers (payable only upon a transfer of the franchise agreement), renewal (payable only upon renewal of the franchise agreement), training, additional support and assistance, and membership in a franchisee membership organization.

Financing the Franchise

Any financing arrangements offered by the franchisor are contained in the FDD. Often, this part will simply indicate that the franchisor does not provide any type of financing. If any financial aid is provided, the amount, interest rate, required collateral, potential liabilities upon default and any other terms and conditions must be included. Remember that you do not have to use the franchisor or its lender simply because they offer to help. Compare loan and lease services at other financial or leasing organizations as well.

VI. Rights and Responsibilities of the Franchisee and Franchisor

Franchisee Obligations

The FDD contains information regarding the franchisee's obligations to buy or lease from the franchisor or a supplier designated by the franchisor. The franchisor must also disclose any revenues or other benefits it received as a result of any required purchases or leases. Don't forget that there are many costs not paid by the franchisor. Be sure to include these in your financial estimates.

Make sure you understand the circumstances under which you and your family members may be held personally liable. Under what circumstances will you be personally liable when a customer, vendor or other person sues? Who will be responsible for the various obligations under the contract? Are there restrictions on other activities of the franchisee and his/her family members with regard to ownership, employment, participation in competitive businesses, etc. Do certain restrictions conflict with any current or foreseeable business interests of the franchisee or family members?

Franchisor Obligations

The franchisor has many different obligations to you prior to the business opening, during the term of the franchise agreement, relating to site location, providing a training program, and estimating the length of time needed to open a center following the signing of a franchise agreement or the payment of a fee to the franchisor.

Ask if there is an operations manual. If so, read it carefully. It will tell you what standards of operation the franchisor expects of the franchisees. You may have to sign an agreement to keep the contents of the manual confidential. Does the manual provide for all aspects of the business? Does it contain an accounting or inventory system? If any of the systems are computerized, is the cost of the computer included in the amounts paid to the franchisor as part of the initial franchise fee?

Find out what training you will receive. Will you learn by hands-on experience at another franchise outlet? If so, how long will you be expected to work there? Will you be paid? Are you the only one who will be trained or will any employees be trained as well? Is there a course that the franchisor provides? How long is it? What type of ongoing training, management assistance and advice will you receive if and when problems arise? The amount of training you will need depends on your present business knowledge and experience and on the operating standards you will be expected to keep.

Franchise Financial Performance Representations

The franchisor is not required to include a performance representation in the FDD. In fact, according to the book "Franchising for Dummies", only about 25% of franchisors do so. If the franchisor does not make a claim of this sort, discussing projected earnings is prohibited, whether it is orally or written on the proverbial Acocktail napkin.@ There are many reasons why the franchisor may choose not to include a financial performance representation in the FDD. If the numbers turn out to be inaccurate or misleading, the

franchisee can sue and the franchisor may even be held personally responsible and face both civil and criminal charges.

Be skeptical about earnings claims. A franchisor will only make a financial performance representation to portray the business in a positive light; for example, using only a small portion of franchised units in making the financial performance representation. Determine how the franchisor arrived at the numbers. Where are the sampled franchises located? How long has that branch been open and what is its competition? Also, understand that it takes a while for a new business to turn a profit. If you are given an earnings claim, you may not realize that kind of profit for a few years.

If a financial performance representation is made, it must include a description of the factual basis behind those numbers. If a financial performance representation is not made, you can estimate how much money any given unit of the franchise might make. Ask other franchisees in the system how much they net and gross monthly. They are not required to disclose this, but many are willing to talk to their potential colleagues. If the franchise is a public company, it is required to provide the Securities and Exchange Commission with financial reports. You can get a copy of these reports from a stock broker or on the SEC website at www.sec.gov in the EDGAR database.

Advertising

Most franchisors assess franchisees for national advertising campaigns. The national advertising fee is usually determined based on a percentage of sales, less frequently as a flat rate. You also may be asked or required to contribute toward regional advertising. Pooling money for more ads to be shown more often is usually beneficial.

Like every other aspect of the franchise agreement, however, the advertising fee section requires cautious review before signing the contract. Where does the money go exactly? What happens to unspent funds? Is the franchisor permitted to change the requirements? Do the franchisees have any input? Who creates the ads? Do all stores contribute at the same rate?

VII. Renewal, Termination and Transfer

Renewal

If you are content with your level of business, you will probably want to renew your franchise agreement. The franchisor, however, reserves the right to refuse your renewal, usually due to extenuating circumstances. For instance, if you are behind in your royalty payments or do not comply with other regulations the franchisor may not want to terminate the franchise. In some cases, renewal clauses are included in the initial contract. Some franchises do not permit renewals at all, while others limit the number of times you can renew.

The franchisor will probably charge a renewal fee. It should be less than the initiation fee you paid when you bought the franchise, because this time you are starting with a solid base. For instance, you do not need to buy equipment or train employees. However, renewal is often a time when a franchisor mandates significant changes or expenses which you may not have anticipated.

The franchise system and the marketplace are subject to change. An agreement signed 10 or 20 years ago will probably need updating to keep up with current trends. Look out for changes in royalty and advertisement fees, territorial rights, remodeling requirements, new equipment, training requirements, renewal terms and material terms of the relationship, such as dispute resolution. These are the aspects which are probably most likely to change. In particular, note how the Internet has affected your business. You or the franchisor, or both, may want to address this in the renewal agreement.

Termination

Termination is also a highly litigated area in franchising. Note what your initial agreement says about each side's right to terminate the relationship. Franchisor may terminate the agreement if they can prove a just cause. This means that the franchisee must fail to uphold some part of the agreement, which would justify the franchisor's decision to terminate. Therefore, it is very important that you understand each provision under which the franchisor has the right to terminate the agreement. These should be clearly stated in the original contract. Also, read what the contract says about the franchisor giving you notice of your failure to complete some aspect of the agreement. Will you have time to correct the error before the franchisor terminates the agreement?

Transfer

It may seem odd to think about selling your franchise before you have even purchased it, but doing so now can prevent problems later. Check the rules relating to transfer agreements. Some franchises prohibit transfers of any kind, while others strictly govern the procedure.

Your franchisor may have a right of first refusal if you decide to sell. This means that if a potential buyer makes an offer, the franchisor has the right to match the buyer's price and, in effect, step in to buy out the business, cutting out the potential buyer.

Your franchisor may also have a right to reject potential buyers. This can be extremely frustrating for a franchisee looking to sell and may also result in selling a franchise for much less than desired. This is usually done in an effort to find more potential buyers, hopefully one who will be acceptable both to you and to the franchisor.

New buyers do not want to come in at the end of the line; they prefer to invest in an ongoing enterprise. Contracts with years remaining and with renewal options are very valuable, as are leases which are not yet due.

VIII. Dispute Resolution

Both the franchisor and the franchisee will probably want to settle disputes in the least costly, time-consuming, and adversarial manner as possible. One option, arbitration, is a proceeding that may be court-supervised or before a private third party. Many franchise agreements require arbitration as the sole means of dispute resolution. Franchisors may also mandate that the proceeding take place in the franchisor's home city, which can be a significant cost to franchisees.

In some cases, it is necessary to have a court resolve your problem. That's why it is so important to understand the details in the contract. Can you afford litigation? Will you be required to litigate in the jurisdiction where your business is located, or must you file suit in the state or country where the franchisor is located? This may vary, so make sure you know the contract terms before you sign it.

Another method of dispute resolution is mediation. A mediator will facilitate the process and help both sides clarify their arguments, but will not make a judgment on the matter. The franchisor and franchisee will resolve the dispute themselves, making all of the major decisions together. Therefore, none of the decisions made are binding.

The difference between arbitration and mediation is that an arbitrator renders a decision which must be followed, while a mediator shuttles between the two parties, discerning their needs and suggesting creative conclusions to bring them to together. Mediation should be used only if you wish to continue operating as a franchisee. If there is little or no trust between you and the franchisor, mediation is unlikely to work.

IX. Important Questions to Ask Present or Former Franchisees

Call and visit several branches of the franchise to see how they operate. Remember that the franchisees are not required to speak with you, so be considerate about arranging times that are convenient for them. Here are some questions you should ask:

- Why did you select this particular franchise system over others in the same type of business?
- What was your employment background prior to becoming a franchisee?

- Did you get the training, quality products, and support you paid for and were promised? Did the promised training take place when you needed it and did the training prepare you to compete with other businesses providing similar products or services? How many hours a week do you work?
- Did you encounter problems with the site while establishing your business and how did the franchisor respond? How long did it take to find a site? How many sites did you locate before the franchisor gave approval of a site?
- How would you describe your overall franchisor/franchisee relationship?
- Is there a franchisee association or advisory council? Was there an incident or problem that caused the franchisees to band together? How long has the association existed? Do the franchisees or the franchisor control the association? What are the current issues? Is there a meeting scheduled that I could attend?
- What is your opinion about how competitive your franchise is with similar businesses? Are there trends that you see in the industry, in the franchisor's business, and in your particular market area?
- Are there other franchisees or former franchisees that you might recommend I contact?
- How often have you found it necessary to refer to your franchise agreement after your business opened? Did the agreement provide the answer to your questions? What do you wish the agreement had included? If many franchisees are turning frequently to their agreements to solve problems with the franchisor, the franchisor/franchisee relationship may not be a healthy one.
- Consider asking whether you could work with a cooperative franchisee for a period of time for free before you commit to your own franchise.
- What are the labor costs as percentage of company sales? What is the percentage of your cost of goods sold in comparison to company sales? How would you describe the quality of the goods or services sold? What are your advertising costs? Are you satisfied with the franchisor's advertising program?
- Did the franchisor make any financial performance representations? If so, are the financial performance representations in line with your earnings?
- Are there any hidden or unexpected costs?
- How long did it take to cover operating costs and earn a livable income?
- Would you purchase another franchise from the franchisor?

If the person is a former franchisee:

- Why did you leave the franchise system?
- Did the franchisor cooperate in helping you sell your franchise?
- Do you own any other franchise or would you buy a franchise from a different franchisor?
- If there was a termination or nonrenewal, did the franchisor explain why and provide a reasonable opportunity for you to cure the problem?
- Were you involved in any legal proceeding or arbitration with the franchisor? If so, what was that like?
- Did you have to file for bankruptcy protection?

Resources

New York State Office of the Attorney General

Investor Protection Bureau

Franchise Section

28 Liberty Street

New York, NY 10005

(212) 416-8200

www.ag.ny.gov/investor-protection/franchisors-franchisees

The Office of the Attorney General (AOAG@) regulates franchising in New York State and accepts written complaints regarding franchisor fraud. Franchise prospectuses can also be obtained from the OAG for .25 cents per page by making a written request and faxing it to the FOIL Officer at (212) 416-8816. The website contains state and federal franchise laws and regulations, appropriate forms to be filed by franchisors and links to other sites.

GOVERNMENT AGENCIES

The Federal Trade Commission
Consumer Response Center
600 Pennsylvania Avenue, NW
Washington, DC 20580
(877) 382-4357
www.ftc.gov/bcp/franchise/netfran.htm

The Federal Trade Commission regulates franchising on the national level. They are responsible for enforcing the FTC Rule, eliminating unfair or deceptive practices, prosecuting violators of franchising laws and consumer education.

United States Small Business
Administration (New York Regional Office)
26 Federal Plaza, Suite 3100, New York,
NY 10278
(212) 264-4354
www.sba.gov

The Small Business Administration provides loans to help small businesses get started and keep running efficiently. They also provide information about starting a small business, as well as upkeep, financing, statistics and disaster protection of your business.

INDUSTRY ASSOCIATIONS

American Association of Franchisees and
Dealers
PO Box 81887, San Diego, CA 92138-1887
(800) 733-9858
www.aafd.org

American Franchise Association
53 West Jackson Boulevard, Suite 1 256,
Chicago, IL 60604
(312) 431-0545
www.franchisee.org

Asian American Hotel Owners Association
66 Lenox Pointe, NE
Atlanta, GA 30324
(404) 816-5759
www.aahoa.com

International Franchise Association
1350 New York Avenue, N.W., Suite 900,
Washington D.C. 20005-4709
(202) 628-8000
www.franchise.org

International Franchise Association:
Franchising Basics and Franchise
Compliance Program
<http://www.ifa-university.com/home>

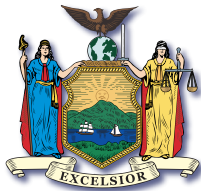
North American Securities Administrators
Association
10 G Street, N.E., Suite 710, Washington, D.C.
20002
(202) 737-0900
www.nasaa.org

OTHER RESOURCES

The Better Business Bureau (New York
Regional Office)
257 Park Avenue South, New York, NY
10100
(212) 533-6200
www.bbb.org

New York State Bar Association
Franchise, Distribution and Licensing Law
Committee
One Elk Street
Albany, NY 12207
(518) 463-3200
[/www.nysba.org](http://www.nysba.org)
Latino Hotel & Restaurant Association
2600 South Shore Blvd Ste 300 League
City, Texas 77573
(281) 668-9165
www.latinhospitality.org

British Franchise Association
<http://www.thebfa.org/>



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