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NASAA Adopts Multi-Unit Franchising Commentary

Part II: Subfranchising

On September 16, 2014, the North American Securities Administrators Association ("NASAA") officially adopted a Multi-Unit Commentary that provides direction on required disclosures for multi-unit franchise arrangements (particularly, area development, area representative and subfranchising arrangements). NASAA adopted the Commentary to clarify ambiguities that have existed since the Federal Trade Commission's issuance of its Amended Franchise Rule in 2008.

Franchisors with a currently effective Franchise Disclosure Document ("FDD") must comply with the commentary within 120 days after the franchisors' next fiscal year ends. New franchisors must comply with the Commentary by March 2015. State regulators, however, will likely refer to the new Commentary in their reviews going forward, so franchisors should review their FDDs as soon as possible to ensure compliance.

Part I of this article focused on certain disclosure

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requirements for area development and area representative arrangements. Part II focuses on subfranchising arrangements.

Although franchisors are not required to use terms identical to those used by NASAA in the Commentary, we suggest using such terms to facilitate reviews by state examiners, since the examiners will likely be using them in their reviews.

Subfranchising

A "subfranchising" arrangement involves a person that is granted the right (for consideration paid to the franchisor) to grant unit franchises to third parties, generally within an outlined geographic area. The franchisor and the subfranchisor enter into a master franchise agreement specifying the territory in which the subfranchisor will operate and a minimum opening schedule. The subfranchisor then enters into unit franchise agreements directly with third parties for unit franchisees (subfranchisees), and is generally obligated to provide support services to those third parties. The franchisor and subfranchisor will share the fees paid by the subfranchisees. Under this structure, the subfranchisor is sometimes called an area franchisor, regional franchisor, or master franchisee.

The Commentary confirms that the franchisor must provide an FDD for its subfranchising offering that is separate from its FDD for its single unit offering. In addition, if a franchisor requires its subfranchisors to use the franchisor's current form of franchise agreement in the sale of unit franchises, the franchisor must include its then-current form of franchise agreement in its subfranchising FDD. The commentary, however, does allow the franchise agreement to be included either as an exhibit to Item 22, or as an attachment to the agreement between the franchisor and subfranchisor with a cross reference in Item 22. Further, since an FDD is not an "agreement," the Commentary does not require that the subfranchisor's FDD for unit franchisees be included within the franchisor's subfranchising FDD.

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Speaking Events

● **January 14, 2015**
- Essex County Bar Association Chancery Section, Judge Benjamin Cohen - Seminar on Mediation

● [January 15-16, 2015](#)
- 16th National Forum on Residential Mortgage Litigation and Regulatory Enforcement in Los Angeles, CA

PIB Law Gives Back

November - Elijah's Promise 6th Annual Turkey Trot

Elijah's Promise fights to end hunger through promoting good food for all, providing education and training for the food industry, and creating social enterprise food businesses that help build a better world. The Turkey Trot specifically raises funds for their community soup kitchen!

With respect to the subfranchisor's unit franchise FDD, the Commentary further requires various types of information regarding the franchisor be included with the information regarding the subfranchisor. This includes information in Item 3 (litigation), Item 4 (bankruptcy), and Item 8 (with respect to rebates). This information must be presented first for the subfranchisor and then for the franchisor. Also, in Item 13, the subfranchisor must disclose information relating to the trademarks to be licensed to the franchisee, and any effect that the termination of the subfranchisor's rights to use such trademarks may have on a subfranchisee's right to them (e.g., will the subfranchisee have the right to continue to use the trademarks in its business). In addition, a subfranchisor's unit franchise FDD must include the required financial statements of both the subfranchisor and the franchisor.

With respect to Item 20's required disclosures relating to "outlets," the franchisor's subfranchising FDD need only disclose information relating to its subfranchisors (and not the unit franchisees). For the subfranchisor's unit franchise FDD, however, the tables in Item 20 must include information for all franchised outlets in the franchisor's system. Therefore, two sets of tables are necessary: the first relating to the subfranchisor's franchised outlets; and the second relating to the franchised outlets for the franchisor's entire franchise system. Likewise, the subfranchisor must include two separate lists of current unit franchisees (and their respective contact information): the first listing the subfranchisor's unit franchisees; and the second listing the unit franchisees of the franchisor and its other subfranchisors. When there are more than 100 unit franchisees in the franchisor's system, the Commentary allows the subfranchisor to limit the list to the unit franchises in the state where it offers unit franchises. But if the subfranchisor has less than 100 unit franchises in such state, it must expand the list to include its unit franchisees in contiguous states, and then the next closest states, until the list reaches 100 (or until there are none left to list). If the total is still less than 100, it must list the unit franchisees of the franchisor and its other subfranchisors in the same manner.



November - Operation Gratitude

All offices collected candy from Halloween and donated to the troops overseas. Operation Gratitude annually sends 150,000+ care packages filled with snacks, entertainment, hygiene and hand-made items, plus personal letters of appreciation, to New Recruits, Veterans, First Responders, Wounded Warriors, Care Givers and to individually named U.S. Service Members deployed overseas.



December - "Adopt a Family"

For the past two holiday seasons, our Somerset

Finally, the Commentary provides guidance on updating the subfranchisor's unit franchise FDD if the franchisor and the subfranchisor have different fiscal years. In such a case, the subfranchisor's annual update must include any required material changes included in the franchisor's quarterly updates. In addition, the subfranchisor must provide the franchisor quarterly updates of material changes for the franchisor to include in its annual update.

The full text of the Commentary can be found at: <http://www.nasaa.org/wp-content/uploads/2011/08/Franchise-Multi-Unit-Commentary-effective-Adopted-Sept.-16-2014.pdf>.

The foregoing information is provided only as a guide. It is not a full summary of requirements relating to multi-unit offerings under franchise and business opportunity laws. Legal advice may be provided based only on specific facts. Accordingly, please check with us before relying on the general information stated herein.

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SEC Touts Banner Year for Enforcement

The Securities and Exchange Commission ("SEC") recently announced its enforcement statistics for fiscal year 2014. The report provides valuable insight into the agency's enforcement priorities and strategies.

Overall, the SEC had a record year. It filed a record 755 enforcement actions and collected \$4.16 billion in disgorgement and penalties. By comparison, in 2013, the SEC brought 686 enforcement actions and obtained orders totaling \$3.4 billion in disgorgement and penalties.

office participated in The Children's Home Society of New Jersey's Adopt-A-Family program. Both times were a huge success and made a big difference by bringing happiness to children and families who have fallen on hard times due to a recent loss of employment or unforeseen hardship through donations of clothes, toys, and non-perishable items.



The success of the Dodd-Frank Whistleblower was among the SEC's most notable achievements. The agency made payments to nine whistleblowers, including a record \$30 million award to a whistleblower whose tip led to a successful enforcement action. The SEC also [brought its first charges under the anti-retaliation provisions of the financial reform statute](#). As previously reported on our blog, the SEC alleged that Paradigm Capital Management terminated its head trader after she notified the regulator that the firm had engaged in prohibited principal transactions.

The SEC report also emphasized several other new priorities. The agency noted that it brought several "first-ever" cases, including actions involving the market access rule, the "pay-to-play" rule for investment advisers, and an emergency action to halt a municipal bond offering.

Below are several other matters [highlighted in the SEC's press statement](#):

- **Insider trading:** The SEC charged 80 individuals for trading on inside information, including hedge fund traders, investment bankers, accountants, and corporate executives. The agency credited new analytical tools with helping to identify patterns of suspicious trading.
- **Disclosure violations:** The SEC charged more than 135 parties with violations related to reporting and disclosure. Most recently, the agency charged 34 individuals and companies for failing to promptly report information about their holdings and transactions in company stock. The SEC detected the filing deficiencies by using quantitative analytics.
- **Investment advisers:** The SEC continued to crack down on advisers. The agency charged three firms with failures to maintain adequate controls on the custody of customer accounts. It also filed its first action arising from a focus on fees and expenses charged by private equity firms.

In terms of litigation, the SEC noted several actions in which the agency required acknowledgements of wrongdoing as a condition of settlement. Under the new admissions policy, cases potentially requiring admissions include: cases where a large number of investors have been harmed or the conduct was otherwise egregious; cases where the conduct posed a significant risk to the market or investors; cases where admissions would aid investors deciding whether to deal with a particular party in the future; and cases where reciting unambiguous facts would send an important message to the market about a particular case.

The agency also touted its use of technology, including enhanced use of data and quantitative analysis, to uncover alleged wrongdoing. As noted by SEC Chair Mary Jo White, the innovative use of technology was "instrumental in detecting misconduct and

contributed to the Enforcement Division's success in bringing quality actions that resulted in stiff monetary sanctions."

Looking ahead, the SEC vowed to continue its aggressive enforcement "across a broad range of the financial industry, from complex accounting fraud and market structure cases, to investment adviser and municipal securities cases, microcap fraud, insider trading, and cases against gatekeepers." Given the rise in enforcement activity, regulated firms are encouraged to re-evaluate their compliance policies and procedures to identify any potential weaknesses, particularly in light of the SEC's concerns.



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