



Earnings Claims: Avoiding Liability for Franchisees' Expectations

The question most frequently asked by prospective franchisees is "How much money can I expect to make?" Many franchisors want to provide this information, since what active franchisees earn is a useful indicator of a franchise's value. However, presentation of such data is not without its pitfalls.

Franchisors can present information on actual or projected sales or earnings of the franchised business, or "earnings claims," provided that they comply with the relevant federal and state regulations concerning such presentations. In fact, franchise sales regulators encourage franchisors to provide earnings claims to potential franchisees, in compliance with such rules.

To provide such information, the franchisor must:

- Provide the "earnings claims" in writing and disclose the full "claim" in Item 19 of the Franchise Offering Circular

- Verify that the earnings claims have a reasonable basis
- Make sure that the earnings claim will not be misleading or be prone to misinterpretation.

Failure to follow these three simple rules can expose franchisors to liability for their franchisees' losses. Within these rules franchisors can choose any format they wish as far as disclosing earnings claims.

The simplest earnings claim can simply be the average gross sales number taken from franchisees' royalty reports. More complex claims can present data categorized by duration of operation, geographic location or other criteria.

When designing an earnings statement, a franchisor should want prospective franchisees to see that if they work hard they have the potential, after their business has estab-

lished itself, to earn a certain amount of money. Franchisors should not want to give the impression that as soon as franchisees open their doors they will make money. This impression will detract from the system as a whole and may lead to disappointed franchisees who try to sue the franchisor for their losses.



As a franchisor's executives decide what image and figures to distribute to prospective franchisees, they should consult with an attorney who has experience with earnings claims issues and an accountant who has compiled pro formas and earnings claims.

This article is an excerpt from our firm's BLOG, which can be found at blog.franbuslaw.com.

Recent Developments at the Franchise & Business Law Group



David L. Cahn

Franchise & Business Law Group exhibited at the 15th annual International Franchise Expo (IFE) earlier this summer in Washington, D.C. The IFE was attended by approximately 14,000

people and featured 331 exhibitors, including franchisors representing over 30 industry sectors.

Founder David Cahn has been awarded the prestigious honor of being selected as a speaker at the 2006 American Bar Association's Forum on Franchising. This convention, which will be held this October in Boston, Massachusetts, features many of the top attorneys involved in franchising.

Mr. Cahn has also received the designation of "Legal Eagle" from Franchise Times magazine and is the only Maryland attorney to receive this award.

Franchise and Business Law Group is growing rapidly. The firm now represents 14 franchisors, with several more expected to engage us shortly, as well as many franchisees and other business clients. We appreciate your business and referrals.

Did You Know? Recent Developments in Maryland Law



Commercial Landlord & Tenant / Renewal Options

Chesapeake Bank of Maryland v. Monro Muffler/Brake, Inc., Maryland Court of Special Appeals, January 31, 2006

Where a lease contract contains an express and clear option to renew, the terms of the renewal provision must be followed to the letter. If a tenant does not send its notice of intent to renew before the deadline in the lease, the tenant forfeits its renewal right -- regardless of the reason for delay.

If you intend to renew your lease, make sure to notify your landlord before the deadline set forth in the lease -- and bookmark that deadline in more than one place.

Employment Law

Provident Bank of Maryland v. McCarthy, U.S. District Court, D. Md., August 23, 2005

"Termination pay" promised to a high-level manager in his employment contract with Provident Bank constituted "wages" under the Wage Payment Collection Act, a statute that, under some circumstances, entitles an employee to an award of three times the wages owed and reasonable attorneys' fees if he or she wins in court.

As an employer, if you decide not to pay your employee compensation claimed after termination,

you had better be sure the employee is not entitled to that compensation.

Fraudulent Inducement to Contract

Rozen v. Greenberg, Maryland Court of Special Appeals, October 7, 2005

A party can be liable for fraudulent inducement to contract when that party (1) made a false statement; (2) knew the statement was false, or was recklessly indifferent to its truthfulness; (3) made the statement to convince some else to enter into a contract; (4) the other party reasonably relied on the statement; and (5) the other party suffered compensable injury because of the contract. Unless the falsity of the representation should have been fairly obvious, the other party is justified in relying on a factual representation and is not required to investigate it. Since the defendant falsely stated his level of work experience and other business to induce the plaintiff to sell her client list, the defendant was liable for the plaintiff's damages caused by entry into the contract.

Be wary of your words; a little white lie to close a deal may result in steep fines.

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The courtroom is not the place to discover if you are on safe ground in your business practices. Accordingly, this newsletter describes a common issue in franchising, as well as recent business law rulings in Maryland courts. We also have included highlights of recent developments at Franchise & Business Law Group.