



SBA Policy Notice

TO: All SBA Employees, 7(a) Lenders and Certified Development Companies **CONTROL NO.:** 5000-1941

SUBJECT: Changes to the Franchise Review Process for 7(a) and 504 Loans **EFFECTIVE:** 2/14/2017

The U.S. Small Business Administration (SBA) is announcing temporary changes to the recently revised franchise review process for the 7(a) and 504 loan programs. These changes will further improve the review process for franchise, license, dealer, jobber or similar agreements (collectively referred to as “franchise agreements”) as currently set forth in SBA’s Standard Operating Procedure (SOP) 50 10 5(I). As further described below, the changes will temporarily permit a 7(a) lender or Certified Development Company (CDC) to submit a certification from the franchisor together with an addendum previously negotiated with SBA in lieu of the SBA Addendum to Franchise Agreement (SBA Form 2462) that is required under the current version of the SOP. In addition, SBA has revised the SBA Addendum to Franchise Agreement (SBA Form 2462) to, among other things, incorporate agreements other than “franchise agreements” (e.g., license, dealer, jobber agreements).

Effective immediately and until further notice, SBA will accept either of the following as sufficient to establish that a franchisee is not “affiliated” with a franchisor: (1) the revised SBA Addendum to Franchise Agreement; or (2) a Certification (in the form attached to this Notice) together with the franchisor’s SBA negotiated addendum. SBA also is making some additional changes to the franchise review process to clarify the requirements for 7(a) lenders and CDCs.

Background

In order to be eligible for financial assistance under SBA’s loan programs, a business must be “small.” The Small Business Act defines a small business as “one which is independently owned and operated and which is not dominant in its field of operation.” 15 U.S.C. § 632. When a business is not independently owned and operated, but is instead affiliated with another business, SBA aggregates the employees, receipts or other measure of size of the business and all of its affiliates to determine whether the business is small.

For businesses operating under a franchise agreement, SBA regulations state that SBA will find affiliation between a franchisor and franchisee if the franchisee does not retain the right to profit from its efforts or bear the risk of loss commensurate with ownership. 13 CFR § 121.301(f)(5). Over the years SBA has reviewed various franchise agreements containing terms and conditions that impact these criteria, and identified those that resulted in a finding of affiliation between the franchisor and franchisee. SBA worked with individual franchisors to resolve any issues that resulted in a finding of affiliation, creating an addendum for use in connection with SBA loans, thereby eliminating the finding of affiliation. This type of addendum is referred to in this Notice as an “SBA Negotiated Addendum.”

In order to streamline and improve the franchise review process, on November 22, 2016, SBA issued SOP 50 10 5(I) which became effective January 1, 2017. This version of the SOP revised the review

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SBA Form 1353.1 (12-93) MS Word Edition; previous editions obsolete
Must be accompanied by SBA Form 58

process for franchise agreements and adopted a new SBA Addendum to Franchise Agreement (SBA Form 2462) for use in all cases when an agreement or relationship meets the Federal Trade Commission (FTC) definition of a franchise in 16 CFR § 436. The new SBA Addendum to Franchise Agreement replaced all of the individual SBA Negotiated Addenda for purposes of resolving any affiliation issues arising under a franchise agreement.

This Notice temporarily revises the current process and clarifies the requirements for lenders and CDCs submitting applications for franchise loans to SBA.

Revisions and Clarifications to the Franchise Review Process

1. Alternative Documentation: Certification (SBA Form 2463) and SBA Negotiated Addendum

On January 1, 2017, the SBA Negotiated Addendum process was replaced with the SBA Addendum to Franchise Agreement (“SBA Addendum”) for all cases. SBA is now temporarily revising the current policy to allow for the use of an alternative to the SBA Addendum: a Certification by the franchisor together with the franchisor’s SBA Negotiated Addendum. The SBA Negotiated Addendum must be an addendum that was developed by SBA and the franchisor in connection with either a 2015 or 2016 version of a franchise agreement. **If the franchisor does not have an SBA Negotiated Addendum with a 2015 or 2016 date, this certification alternative cannot be used and the lender must obtain the SBA Addendum.**

The Certification (SBA Form 2463) will be executed by the franchisor and used with an SBA Negotiated Addendum to resolve any affiliation issues that arise in a particular franchise agreement.¹ Specifically, the franchisor will certify that SBA has previously reviewed its 2015 or 2016 franchise agreement, including the SBA Negotiated Addendum, and determined that the Franchise Agreement with the SBA Negotiated Addendum did not create an affiliate relationship between the franchisee and franchisor. The franchisor will also certify that the terms of the loan applicant’s franchise agreement have not changed from those of the 2015 or 2016 franchise agreement, as such terms relate to affiliation (as defined in 13 CFR part 121 and SOP 50 10) between the franchisor and the franchisee, and that the loan applicant’s franchise agreement includes the SBA Negotiated Addendum. The Certification is attached to this Notice as Attachment 1 and will be available on SBA’s website at www.sba.gov/for-lenders.

2. Revisions to SBA Addendum to Franchise Agreement (SBA Form 2462)

SBA has received numerous comments relating to the language in the SBA Addendum, particularly the use of the terms “franchise agreement,” “franchisor,” and “franchisee,” when the document is also required for license, dealer, distributor, jobber, or similar agreements. SBA also identified other issues that needed clarification, including the language discussing covenants and employment. The following changes have been made to the SBA Addendum to clarify SBA’s intent:

¹ While relationships established under license, jobber, dealer and similar agreements are not generally described as “franchise” relationships, if such relationships meet the Federal Trade Commission’s (FTC’s) definition of a franchise (see 16 CFR § 436), they are treated by SBA as franchise relationships for purposes of affiliation determinations per 13 CFR § 121.301(f)(5). In addition, the Certification will include the ability to customize the document to reflect franchisor, licensor, distributor, jobber, etc. as appropriate.

- a) The SBA Addendum now includes a drop down box to allow the entity to select the appropriate type of agreement (e.g., franchise, license, jobber), and the proper titles of the parties to the agreement (e.g., franchisor/franchisee, licensor/licensee). The SBA Addendum will also allow the manual entry of other types of agreements (e.g., member agreements), or to fill in a specific name of an entity, rather than “franchisor.”
- b) The language under the heading “Covenants” has been clarified to address any restrictions that may already be recorded against the franchisee’s real estate. Any such restriction must be removed from the title in order for the Franchisee to obtain SBA-assisted financing.
- c) The language under the heading “Employment” has been revised to clarify that for temporary personnel franchises, the temporary employees will be employed by the Franchisee not the Franchisor.
- d) The language regarding termination of the SBA Addendum has been clarified.
- e) The signature blocks have been revised to include language stating the persons signing the SBA Addendum are authorized to do so.

The revised SBA Addendum is attached to this Notice as Attachment 2 and will be available on SBA’s website at www.sba.gov/for-lenders.

3. Applicants Operating with Multiple Agreements

In accordance with SOP 50 10 5(I), SBA requires a review of every agreement the Small Business Applicant will operate under in order to determine if the agreement meets the FTC definition of franchise and, if it does, SBA requires the use of an addendum to resolve any affiliation based on franchise relationship issue. SBA recognizes that there are situations where a Small Business Applicant may operate under one or more agreements where some of the agreements (either individually or in the aggregate) do not constitute a critical part of the Small Business Applicant’s total business operation.

Accordingly, SBA is revising its current policy as follows:

When an applicant franchisee operates under one or more agreements, SBA will only require review of the agreement(s) (or product, service or trademark covered by such agreement(s)) that are critical to the Small Business Applicant’s business operation in order to determine if the agreement(s) meets the FTC definition of a franchise and, therefore, requires either (i) the SBA Addendum to Franchise Agreement or (ii) the Certification with the SBA Negotiated Addendum. As a general rule, SBA considers agreements (or products, services or trademarks covered by such agreements) to be “critical” when they account, individually or in the aggregate, for at least 67% of the applicant’s revenues.

4. Clarification to Required Documentation and Timing

When reviewing an application for an SBA loan that involves a franchise relationship or agreement (whatever it may be called), 7(a) lenders and CDCs must follow the process set forth below:

- Determine whether the applicant has an agreement or relationship that is critical to its business operation and, if so, determine whether it meets the FTC definition of franchise in 16 CFR § 436.
- If the agreement meets the franchise definition, obtain either the SBA Addendum or the Certification and SBA Negotiated Addendum.
- When processing under its delegated authority, the 7(a) lender or CDC must obtain an executed copy of the franchise agreement, either the executed SBA Addendum or Certification and SBA Negotiated Addendum, and all other documents the franchisor requires the franchisee to sign prior to any disbursement of a 7(a) loan and prior to closing a 504 loan. PCLP CDCs must provide the executed SBA Addendum or Certification and SBA Negotiated Addendum to the SLPC prior to loan closing. In addition, the 7(a) lender and CDC must ensure that the system meets all SBA eligibility requirements, and must review all other documents the franchisor requires the franchisee to execute to ensure compliance with either addendum and SBA Loan Program Requirements (e.g., there are no restrictions recorded against the real estate).
- When submitting an application under non-delegated processing:
 - the 7(a) lender must submit a copy of the agreement and the SBA Addendum or the Certification and SBA Negotiated Addendum (whether executed or not), along with any related documents the franchisor requires the franchisee to execute with their loan documentation to the LGPC;
 - the CDC must submit a copy of the agreement and the SBA Addendum or the Certification and SBA Negotiated Addendum (whether executed or not), along with any related documents the franchisor requires the franchisee to execute to the SLPC prior to submitting the application for review. In addition, the executed SBA Addendum or Certification and SBA Negotiated Addendum must be provided to the SLPC prior to loan closing.

In all cases, the franchise agreement, including any amendments and/or addenda, must be executed by the franchisor and the franchisee prior to any disbursement on a 7(a) loan and prior to submitting the closing package to SBA for debenture funding on a 504 loan.

5. Loan Authorization Language

SBA recognizes that, in some cases, an addendum is not executed prior to loan approval. SBA will allow a 7(a) lender or CDC to submit a loan application without the executed addendum provided the executed documents are obtained prior to any disbursement of a 7(a) loan and prior to closing a 504 loan (as discussed above). In such cases, the following language must be manually inserted into the Authorization Boilerplate:

7(a):

“Lender must obtain the executed Franchise Agreement, either (i) the SBA Addendum to Franchise Agreement (SBA Form 2462), or (ii) the Certification (SBA Form 2463) and SBA Negotiated Addendum, and all other documents the franchisor requires the franchisee to sign prior to any disbursement of Loan proceeds and retain in the loan file. Failure to obtain the executed documents may result in a denial of liability on the guaranty.”

504:

“**Franchise** - CDC must obtain the executed Franchise Agreement, either (i) the SBA Addendum to Franchise Agreement (SBA Form 2462), or (ii) the Certification (SBA Form 2463) and SBA Negotiated Addendum, and all other documents the franchisor requires the franchisee to sign.”

This language will be manually inserted into the Authorization Boilerplate by the LGPC or SLPC for non-delegated loans. For delegated loans, this language must be manually inserted into the Authorization Boilerplate by the lender or PCLP CDC. The language can be manually inserted into the “prior to closing” section of the 7(a) or 504 Authorization Boilerplate by clicking “Edit” and adding the language above.

Questions

Questions and any comments concerning this Notice should be directed to the lender relations specialist in the local SBA field office. The local SBA field office may be found at www.sba.gov/about-offices-list/2. Questions or comments on the revised franchise review process may be submitted to FranchiseFY2017@sba.gov.

Joseph P. Loddo
Acting Administrator

Attachments (2)

FRANCHISOR¹ CERTIFICATION FOR USE WITH SBA NEGOTIATED ADDENDUM

Full legal name of Franchisor:

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This Certification is to be used only if (1) the 2015 or 2016 version of the Franchisor's franchise agreement² was reviewed by SBA and (2) a franchisee applying for SBA financial assistance is or will be operating under a version of the Franchisor's franchise agreement (the "Current Franchise Agreement") that (a) includes the SBA Negotiated Addendum (as defined below) and (b) the terms of which that affect "affiliation" between the franchisor and the franchisee (as defined in 13 CFR part 121 and SOP 50 10) are unchanged from the franchise agreement reviewed by SBA.

Franchisor certifies that SBA has previously reviewed its [INSERT EITHER "2015" or "2016"] franchise agreement, including an addendum (the "SBA Negotiated Addendum"), for the above referenced franchise and determined that the franchise agreement with the SBA Negotiated Addendum did not create an affiliate relationship between the Franchisee and Franchisor. Franchisor further certifies that the Current Franchise Agreement includes the SBA Negotiated Addendum and that the terms of the Current Franchise Agreement, entered into on _____, 20__, with _____ ("Franchisee"), an applicant for SBA financial assistance, that affect "affiliation" between the franchisor and the franchisee (as defined in 13 CFR part 121 and SOP 50 10) have not changed from those appearing in the franchise agreement reviewed by SBA.

Franchisor certifies that all of the statements and information provided in this Certification are true, accurate and complete, and Franchisor understands and acknowledges that SBA will rely upon this Certification for the purpose of determining size eligibility of the Franchisee for SBA financial assistance. Franchisor acknowledges that submission of false information to SBA, or the withholding of material information from SBA, can result in criminal prosecution under 18 U.S.C. 1001 and other provisions, including liability for treble damages under the False Claims Act, 31 U.S.C. §§ 3729-3733.

I am a duly authorized representative of the Franchisor and have the authority to sign this Certification on its behalf.
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Signature	Date __/__/__
Print Name (First, Middle, Last)	
Title	
Company Name	

¹ While relationships established under license, jobber, dealer and similar agreements are not generally described as "franchise" relationships, if such relationships meet the Federal Trade Commission's (FTC's) definition of a franchise (see 16 CFR § 436), they are treated by SBA as franchise relationships for purposes of affiliation determinations per 13 CFR §121.301(f)(5).

² The term franchise agreement includes all addenda, amendments and other documents that are part of the franchise agreement.



Attachment 2
ADDENDUM TO FRANCHISE¹ AGREEMENT

THIS ADDENDUM (“Addendum”) is made and entered into on _____, 20____, by and between _____ (“Franchisor”), located at _____, and _____ (“Franchisee”), located at _____.

Franchisor and Franchisee entered into a Franchise Agreement on _____, 20__, (such Agreement, together with any amendments, the “Franchise Agreement”). Franchisee is applying for financing(s) from a lender in which funding is provided with the assistance of the U. S. Small Business Administration (“SBA”). SBA requires the execution of this Addendum as a condition for obtaining SBA-assisted financing.

In consideration of the mutual promises below and for good and valuable consideration, the receipt and sufficiency of which the parties acknowledge, the parties agree that notwithstanding any other terms in the Franchise Agreement:

CHANGE OF OWNERSHIP

- If Franchisee is proposing to transfer a partial interest in Franchisee and Franchisor has an option to purchase or a right of first refusal with respect to that partial interest, Franchisor may exercise such option or right only if the proposed transferee is not a current owner or family member of a current owner of Franchisee. If the Franchisor’s consent is required for any transfer (full or partial), Franchisor will not unreasonably withhold such consent. In the event of an approved transfer of the franchise interest or any portion thereof, the transferor will not be liable for the actions of the transferee franchisee.

FORCED SALE OF ASSETS

- If Franchisor has the option to purchase the business personal assets upon default or termination of the Franchise Agreement and the parties are unable to agree on the value of the assets, the value will be determined by an appraiser chosen by both parties. If the Franchisee owns the real estate where the franchise location is operating, Franchisee will not be required to sell the real estate upon default or termination, but Franchisee may be required to lease the real estate for the remainder of the franchise term (excluding additional renewals) for fair market value.

¹ While relationships established under license, jobber, dealer and similar agreements are not generally described as “franchise” relationships, if such relationships meet the Federal Trade Commission’s (FTC’s) definition of a franchise (see 16 CFR § 436), they are treated by SBA as franchise relationships for franchise affiliation determinations per 13 CFR § 121.301(f)(5).

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COVENANTS

- If the Franchisee owns the real estate where the franchise location is operating, Franchisor has not and will not during the term of the Franchise Agreement record against the real estate any restrictions on the use of the property, including any restrictive covenants, branding covenants or environmental use restrictions. If any such restrictions are currently recorded against the Franchisee's real estate, they must be removed in order for the Franchisee to obtain SBA-assisted financing.

EMPLOYMENT

- Franchisor will not directly control (hire, fire or schedule) Franchisee's employees. For temporary personnel franchises, the temporary employees will be employed by the Franchisee not the Franchisor.

As to the referenced Franchise Agreement, this Addendum automatically terminates when SBA no longer has any interest in any SBA-assisted financing provided to the Franchisee.

Except as amended by this Addendum, the Franchise Agreement remains in full force and effect according to its terms.

Franchisor and Franchisee acknowledge that submission of false information to SBA, or the withholding of material information from SBA, can result in criminal prosecution under 18 U.S.C. 1001 and other provisions, including liability for treble damages under the False Claims Act, 31 U.S.C. §§ 3729 -3733.

Authorized Representative of FRANCHISOR:

By: _____

Print Name: _____

Title: _____

Authorized Representative of FRANCHISEE:

By: _____

Print Name: _____

Title: _____

Note to Parties: This Addendum only addresses "affiliation" between the Franchisor and Franchisee. Additionally, the applicant Franchisee and the franchise system must meet all SBA eligibility requirements.