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**ADVANCED DISCLOSURE ISSUES
UNDER THE AMENDED FTC RULE**

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*Mr. Tregillus and Mr. Cantone will serve as panelists during the oral presentation of this paper at the annual ABA Forum on Franchising meeting in October 2008, but neither Mr. Tregillus nor Mr. Cantone participated in the preparation of this paper. The opinions and observations expressed by Messrs. Cantone and Tregillus during the oral presentation will be their own and will not necessarily represent the views of the Federal Trade Commission or any individual Commissioner, the Attorney General of Maryland or the Maryland Attorney General's Office, or NASAA.

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I. INTRODUCTION

The Federal Trade Commission (“FTC”) released its amendments to the FTC’s Trade Regulation Rule entitled “Disclosure Requirements and Prohibitions Concerning Franchising”¹ (the “Amended FTC Rule”) in January 2007. The Amended FTC Rule disclosure format is, in most respects, an updated and enhanced version of the North American Securities Administrator Association’s (“NASAA”) Uniform Franchise Offering Circular (“UFOC”) disclosure format.

The Amended FTC Rule became effective on July 1, 2007, although the FTC permitted franchisors to continue to use the original FTC Rule, including NASAA’s UFOC disclosure format, until July 1, 2008. As of July 1, 2008, all franchisors were required to comply with the Amended FTC Rule and have their franchise disclosure documents converted to the Amended FTC Rule disclosure format.

Much has been written and discussed about the Amended FTC Rule since its release in January 2007, and, by the time of the annual Forum meeting, most franchise practitioners will have had experience preparing franchise disclosure documents (“FDDs”) under the Amended FTC Rule and filing those FDDs in the franchise registration states. We have assumed for the purposes of this paper that the reader has a baseline knowledge of the requirements and prohibitions under the Amended FTC Rule. Therefore, this paper will not discuss in detail all of the revisions made to the original FTC Rule or the differences between the Amended FTC Rule and the UFOC Guidelines.²

Instead, this paper focuses on disclosure issues under the Amended FTC Rule that may be unclear or are particularly problematic, other disclosure and compliance issues that may not be apparent on a superficial reading of the Amended FTC Rule, and any guidance or clarification that the FTC has provided to date. Where appropriate, this paper will also discuss NASAA and state responses to the Amended FTC Rule, including certain state comments received with respect to FDD filings and proposed responses.

This paper was prepared well in advance of the annual Forum meeting. To the extent that there are clarifications made by the FTC, NASAA or the states or further developments between the completion of this paper and the Forum meeting, those issues will be discussed during the presentation of this paper.

II. KEY DOCUMENTS/SOURCES

The key documents and sources used in the preparation of this paper included the following:

- The Amended FTC Rule (16 C.F.R. pt. 436). The Amended FTC Rule is available on the Internet from the GPO at <http://ecfr.gpoaccess.gov/cgi/t/text/text->

¹ 16 C.F.R. pt. 436 (2008). The full text of the official version of the Amended FTC Rule is found in the Federal Register, Vol. 72, No. 61 at pages 15444–63 (March 30, 2007).

² For an excellent discussion of key disclosure revisions under the Amended FTC Rule as compared to the UFOC Guidelines, see the paper entitled, [Practical Disclosure Issues Under the Amended FTC Franchise Rule: The Final Word?](#), by John Baer, Shelley Harris-Horn, and Steve Toporoff, which was presented at the annual ABA Forum on Franchising meeting in October 2007.

[idx?c=ecfr&sid=a4d5f9ffd8a3223b1a1af177ce1fca18&rgn=div5&view=text&node=16:1.0.1.4.50&idno=16](http://www.ftc.gov/os/2007/01/R511003FranchiseRuleFRNotice.pdf). Consistent with the citation format in the Amended FTC Rule and the Statement of Basis and Purpose, we will cite only the Section number of 16 C.F.R. when citing the Amended FTC Rule in this paper (e.g., § 436.2(a)).

- The Amended FTC Rule Statement of Basis and Purpose (72 Fed. Reg. 15445-15544 (March 30, 2007)) (“Statement of Basis and Purpose”). The Statement of Basis and Purpose is available on the Internet at <http://www.ftc.gov/os/2007/01/R511003FranchiseRuleFRNotice.pdf>.
- Franchise Rule Compliance Guide (“Compliance Guide”). The Compliance Guide is available on the Internet at <http://www.ftc.gov/bcp/franchise/franchise-rule-compliance-guide.pdf>.
- The FTC’s Frequently Asked Questions, known as “Amended Franchise Rule FAQs” (“FAQs”). The FAQs are available on the Internet at <http://www.ftc.gov/bcp/franchise/amended-rate-faqss.shtml>. FAQs are issued periodically, so the website noted above should be referred to. A copy of the current FAQs is attached to this paper as **Appendix A**.
- FTC Staff Advisory Opinions (Bus. Franchise Guide (CCH) ¶¶ 6380 to 6533). The FTC Staff Advisory Opinions are available on the Internet at <http://www.ftc.gov/bcp/franchise/netadopin.shtml>.
- State franchise registration and disclosure law statutes and regulations (Bus. Franchise Guide (CCH) ¶¶ 3000 to 3520, and ¶¶ 5050 to 5490).
- 2008 NASAA Franchise Registration and Disclosure Guidelines (“NASAA FDD Guidelines”). The NASAA FDD Guidelines are available on the Internet at <http://www.nasaa.org/content/Files/2008UFOC.pdf>. A copy of the NASAA FDD Guidelines is attached to this paper as **Appendix B**.

III. ANALYSIS OF THE AMENDED FTC RULE, INCLUDING NASAA AND STATE RESPONSES AND INTERPRETIVE ISSUES

A. Delivery Requirements

1. 7 Day Rule

Under the original FTC Rule, franchisors were required to provide prospective franchisees with a final copy of the franchise and related agreements with all material blanks filled in at least five business days before the agreement was to be signed. That “5 business day rule” was eliminated in the Amended FTC Rule.

However, under the Amended FTC Rule, if a franchisor unilaterally and materially alters the terms or conditions of the form franchise agreement or related agreements that are attached to the FDD, the franchisor must provide a copy of the revised agreement(s) to the prospective franchisee at least seven calendar days before the prospective franchisee signs the

agreement.³ (Changes that result from negotiations initiated by the prospective franchisee do not trigger this seven day hold requirement.)

At first glance a franchisor may not believe that the 7 day rule will apply to it very often since, after all, most changes to the form franchise agreement arise out of negotiations that the franchisee initiates. Additionally, the Statement of Basis and Purpose states that the 7 day rule will not be triggered when the franchisor completes “fill-in-the-blank” provisions, such as the name and address of the franchise and the date of the agreement.⁴

However, the Statement of Basis and Purpose and FAQ #10 make clear that if “substantive contractual details”, such as the geographic area of a protected territory, fees, and interest rates, are not disclosed in the FDD or its attachments, those terms must be inserted into the franchise agreement and the completed agreement must be provided to the prospective franchisee at least seven calendar days before the prospective franchisee signs. For example, if the form franchise agreement provides for territorial protection in a geographic area but there is a blank in the form franchise agreement for the protected territory to be filled in before the agreement is signed, the 7 day rule will apply.

However, FAQ #10 states that if the protected territory has been previously disclosed, but the exact name or other circumstances are not known at the time of disclosure (e.g., “We grant territories based on the county in which your unit will be located. Your protected territory will be [county], [state]”), inserting specific information applicable to the prospective franchisee will not trigger the 7 day rule since information sufficient to enable the prospective franchisee to determine the geographic area that would be applicable to its franchise was disclosed as part of the FDD (in this example, the exact county and state).

2. State Issues

Under the Amended FTC Rule, franchisors are required to provide prospective franchisees with a copy of the franchisor’s current FDD at least fourteen calendar days “before the prospective franchisee signs a binding agreement with, or makes any payment to, the franchisor or an affiliate in connection with the proposed franchise sale.”⁵ Additionally the Amended FTC Rule eliminates the first personal meeting rule.

These simplified delivery requirements are a welcome change from the more cumbersome delivery requirements under the original FTC Rule. However, some states have not yet amended their disclosure delivery requirements to reflect the requirements in the Amended FTC Rule.

Iowa, Maine, Maryland, New York, Oklahoma, and Rhode Island still have a first personal meeting rule, so if a franchisor has a first personal meeting with a prospect in these

³ 16 C.F.R. § 436.2(b).

⁴ See Statement of Basis and Purpose at 15471.

⁵ 16 C.F.R. § 436.2(a). The Compliance Guide clarified that the execution of a pre-sale confidentiality agreement, under which the prospective franchisee agrees not to disclose the contents of the franchisor’s operations manual in consideration for the franchisor permitting the prospective franchisee to review the manual prior to execution of the franchise agreement, by itself, does not trigger the requirement to provide disclosure. See Compliance Guide, Item 11.

states, the franchisor must provide an FDD to the prospect at the first personal meeting that is held to discuss the sale or possible sale of a franchise. Additionally, Connecticut, Maryland, Michigan, New York, Oklahoma, Oregon, Rhode Island, and Washington (if the franchisor is not exempt from the Connecticut business opportunity law) have retained the ten business day disclosure holding period.⁶ Therefore, in these states, a prospective franchisee must hold the FDD for a full ten business days before paying any consideration to the franchisor or its affiliate or signing an agreement related to the franchise. Franchisors must comply with both the Amended FTC Rule requirements (including the 7 day rule discussed above) and the state laws that have different disclosure delivery requirements in the states noted above.

Section III.C. of the NASAA FDD Guidelines requires that franchisors add a statement to the Receipt pages of the FDD to reflect state laws that contain disclosure delivery requirements that differ from the Amended FTC Rule delivery requirements. Language similar to the following should be included in the FDD Acknowledgments of Receipt and should be updated if and when the laws of these states are brought into conformity with the Amended FTC Rule:

Some state franchise laws require the franchisor to provide this disclosure document to you at the first personal meeting held to discuss the franchise sale or at least 10 business days before you sign a binding agreement with, or make a payment to, the franchisor or an affiliate in connection with the proposed franchise sale.

3. Requirement to Provide FDD “Earlier Upon Reasonable Request”

It is an unfair or deceptive act or practice for a franchisor to fail to furnish a copy of the franchisor’s FDD earlier in the sales process than required under Section 436.2 (*i.e.*, 14 calendar days before the prospective franchisee pays any money or signs an agreement) upon reasonable request by the franchisee.⁷

Does this mean that the franchisor is required to provide an FDD to any person who asks for it at any time? The FTC has said “no.” This requirement applies only after the franchisor and prospective franchisee have commenced the franchise sales process.⁸ Given the fact that most franchisors require prospects to complete a franchise application and meet certain minimum qualifications before proceeding with the sales process, a good rule of thumb is that prospective franchisees may request (and franchisors must provide) a copy of the FDD after the application is completed and the franchisor has determined that the prospective franchisee is qualified to move forward in the sales process or otherwise provides a positive response to the application. The Compliance Guide also makes clear that a franchisor is not permitted to charge any fee to a prospective franchisee in connection with its right to receive an FDD prior to the disclosure deadline.

Another important question that is addressed partially by FAQ #14 is what a franchisor should do if a prospective franchisee “reasonably requests” a copy of the FDD when the

⁶ The first personal meeting rule in Iowa, Maine, and Oklahoma and the 10 business day rule in Connecticut and Oklahoma are included in those states’ business opportunity laws.

⁷ See 16 C.F.R. § 436.9(e).

⁸ See Compliance Guide at 21.

franchisor's FDD is no longer current, and the franchisor is in the process of updating its FDD or state registration applications are pending. FAQ #14 states that franchisors should provide the current FDD to prospects upon reasonable request even if an updated FDD is soon to be issued, but, in order to avoid possible misrepresentations, franchisors should advise the prospective franchisee that the franchisor is preparing a revised FDD which will be available to the prospect when it is issued or registered.

The question that FAQ #14 does not directly answer is what a franchisor should do if a prospective franchisee makes a "reasonable request" for a copy of the FDD for a franchise which would be covered by a state franchise registration law and the franchisor does not have an effective registration in that state. In some states (e.g., California and New York) the franchisor may be able to continue to offer franchises while a renewal or amendment application is pending if certain requirements are met, but what should a franchisor do in other registration states that do not have such a provision or in registration states that have this type of provision but the franchisor has no application pending at the time of the request? Should the franchisor provide the FDD to the prospect in order to comply with the Amended FTC Rule, thereby potentially violating the state registration law? One may argue that requesting an FDD for a franchise in a state in which the franchisor is not effectively registered is not "reasonable" and, therefore, the franchisor has no obligation to provide the FDD. Fortunately, in a recently issued FAQ (#24), the FTC provided some clarity on this issue by stating that, as a matter of policy, it would not recommend enforcement action when a material change amendment is pending if the franchisor can demonstrate that it: "(1) advised the prospective franchisee that it was revising its FDD to reflect a material change; and (2) delivered the revised FDD as soon as permitted by the applicable state law, but in any event at least 14 calendar days before the prospective franchisee signed a binding agreement with, or made a payment to the franchisor or an affiliate in connection with the proposed franchise sale."

4. "Pipeline" Re-disclosure

The Amended FTC Rule does not require franchisors to provide an updated FDD to prospective franchisees that have already been disclosed before the prospective franchisee enters into the franchise agreement, even if an updated FDD (or quarterly updates) is available. Prospective franchisees may, however, request an updated FDD before they sign franchise agreements, and the franchisor must provide any update upon such request if available.

Notwithstanding the Amended FTC Rule's lack of a "pipeline" re-disclosure requirement, franchisors must consider whether applicable state law requires such re-disclosure. Further, even in non-registration states, the "best practice" is to re-disclose prospects in the pipeline before the franchise agreement is signed. Doing so may help avoid claims of misrepresentation,⁹ particularly if there has been a material change to the FDD since the prospect was originally disclosed.

B. Form and Formatting

It is critical that FDDs be prepared specifically as required in the Amended FTC Rule, and the disclosures should appear in the exact order set forth in the Amended FTC Rule. For

⁹ See Video Update, Inc. v. Guenther, 741 F. Supp. 172, 174 (D. Minn. 1990) (franchisee was disclosed with 1984 UFOC; while waiting for required pre-sale disclosure period, franchisor was notified that 1985 UFOC had been registered in Illinois, but franchisor did not re-disclose prospective franchisee before signing the franchise agreement).

example, the titles and subtitles of each Item and the column headings and “Provision” descriptions in the Item 17 chart must be exactly as they appear in the Amended FTC Rule. Any variation in the wording will likely draw a comment and requirement to modify the particular language from a state examiner. We discuss some specific examples of comments made by state examiners in this regard in Section III.F. of this paper.

Additionally, Section IV.A.12 of the NASAA FDD Guidelines requires that the FDD must be clearly readable and be in at least 11 point type. Tables in the FDD and ancillary documents attached to the FDD may be in type smaller than 11 point. However, any tables or ancillary documents that are in smaller type must still be clearly readable.

Section II.B. of the NASAA FDD Guidelines requires that initial, renewal, and amendment filings must be submitted both in paper copy and in PDF format on a CD-ROM, and the cover letter transmitting application documents must contain a representation that the paper copies of the documents are identical to the document contained on the CD-ROM. Finally, any blackline documents submitted in connection with a franchise filing must not contain “margin balloons” and must not show changes in color.

C. Exemptions

1. New Exemptions

The Amended FTC Rule contains three new exemptions.¹⁰ The first is the “large investment” exemption, which exempts franchise offers and sales where the initial investment is at least \$1 million, excluding the cost of unimproved land and any financing provided by the franchisor or its affiliate. At least one investor (or owner of an entity franchisee) must invest \$1 million or more in order to qualify for the exemption (in other words, 5 investors investing \$200,000 each would not qualify for the exemption). In order to determine whether the \$1 million threshold is met, the franchisor may consider all amounts that it anticipates will be paid as contemplated in Item 7 prior to opening and during the three-month period following opening. Additionally, if the prospective franchisee is purchasing multiple units as part of the proposed transaction, the franchisor may aggregate the initial investment that the franchisee will make during the Item 7 initial investment period for all of the units in determining whether the threshold is met.

The FTC has also stated that conversion franchises and transfers may qualify for the large investment exemption. With respect to a conversion franchisee (*i.e.*, a business owner who has already invested in and opened a business but wants to convert its business to the franchisor’s brand), the franchisor may consider the franchisee’s previous investment in the business in determining whether the threshold is met, even though these amounts were not paid to the franchisor.

The logic applicable to a transfer is the same as with a conversion franchisee. If the proposed transferee is investing at or above the \$1 million threshold when it purchases an existing franchised outlet, the fact that the money is being paid to someone other than the franchisee will not preclude the franchisor from qualifying under the exemption.¹¹

¹⁰ 16 C.F.R. § 436.8(a)(5)–(6).

¹¹ Compliance Guide at 11.

Importantly, in order to qualify for the large investment exemption, franchisors must obtain a signed acknowledgement from the franchisee which states that the investment in the franchise satisfies the \$1 million threshold. The acknowledgement must be in plain English and “clear and conspicuous” and contain the following prescribed statement:

The franchise sale is for more than \$1 million – excluding the cost of unimproved land and any financing received from the franchisor or an affiliate – and thus is exempt from the Federal Trade Commission’s Franchise Rule disclosure requirements, pursuant to 16 C.F.R. 436.8(a)(5)(i).

It is the franchisor’s burden to prove that the exemption is applicable and that the acknowledgement is received and signed by the prospective franchisee so it is critical that the franchisor obtain the signed acknowledgment and retain it in the franchisor’s permanent files to avoid future claims that the franchisor failed to comply with the Amended FTC Rule.

The second new exemption is the “large franchisee” exemption. The offer and sale of a franchise to a prospective franchisee that has a net worth of at least \$5 million and has been in business for at least 5 years is exempt from the Amended FTC Rule. The Amended FTC Rule does not specify any particular methodology for determining how net worth is to be determined, but franchisors wishing to rely on this exemption should obtain a recent balance sheet to confirm net worth. The balance sheet should either be audited or certified by an appropriate officer of the entity that it is true and correct. With respect to the business experience component, the Statement of Basis and Purpose provides that any business experience of the franchisor or its affiliates or parents may be counted toward the 5 year threshold (i.e., the business experience need not be in franchising or the business that is the subject of the franchise).

The franchisor may aggregate the business experience and net worth of the franchisee’s parents or affiliates in determining whether the large franchise exemption applies.

It is important to note with respect to the large investment and large franchisee exemptions that the FTC built in the ability to adjust the \$1 million and \$5 million thresholds every four years based on inflation.

The third and final new exemption is the “insiders” exemption. This exemption applies to an officer, director, general partner, or manager of the franchisor who: (i) seeks to purchase at least a 50% interest in the franchise; and (ii) has at least 2 years’ experience with the franchisor as an officer, director, general partner, or manager. That association must be current or within sixty days of the proposed purchase. Similarly, the exemption applies to an owner of the franchisor if: (i) the owner seeks to purchase at least a 50% interest in the franchise; and (ii) the owner currently has, or has had within sixty days prior to the sale of the franchise, at least a 25% ownership interest in the franchisor for at least two years.

The critical issue that franchisors must understand with respect to these new “sophisticated franchisee” exemptions is that, although they may facilitate streamlined franchise transactions in certain circumstances in which the exemption qualifications are met, the franchise registration states have not yet adopted these exemptions. Exemptions under state registration laws vary significantly from state to state, and, although some registration states have exemptions which overlap with the new Amended FTC Rule exemptions, there is no

common thread in terms of exemptions provided for in the state franchise registration laws and the Amended FTC Rule.¹² Therefore, the benefit of the new Amended FTC Rule exemptions will likely only be realized in transactions that meet the exemption qualifications in the non-registration states, at least until (and if) the registration states adopt similar exemptions. Given the above, franchisors that generally offer franchises in both registration and non-registration states will need to prepare and maintain an FDD which meets the requirements of the Amended FTC Rule.

2. Exemptions Under the Original FTC Rule

The Amended FTC Rule retains each of the exemptions in the original FTC Rule, including the minimum payments exemption, the fractional franchise exemption, the leased departments exemption, and the oral agreements exemption.

With respect to the minimum payments exemption (which essentially provides that franchise sales are exempt if the franchisee is not required to pay \$500 or more to the franchisor or its affiliates before or during the first six months of the franchisee's operations), there was a minor (but potentially significant) wording change in the Amended FTC Rule that lead some commentators to question whether franchisors could require franchisees to sign a nonnegotiable promissory note for amounts accrued during the first six months of the relationship to be paid following the expiration of such six month period.¹³ Nonnegotiable promissory notes were commonly used by franchisors wishing to take advantage of the minimum payments exemption, and this practice was approved by the FTC in a 1979 Staff Advisory Opinion.¹⁴

The FTC clarified the issue in the Compliance Guide by stating the “[a] commitment entered into during the first six months that requires a payment later than six months after commencing operation (such as a promissory note or that portion of lease payments made after six months) is not counted toward the \$500 minimum.”¹⁵

D. Definitions

The Amended FTC Rule contains a useful definitions section at Section 436.1. It is critical that franchisors and their counsel are familiar with the defined terms under the Amended FTC Rule and refer to the definitions section often because there are a number of new defined terms, and some of the defined terms carried over from the original FTC Rule were modified.

¹² When analyzing the potential applicability of state exemptions, it is important to remember that some exemptions from state franchise registration laws may be exemptions from registration only, in which case, the franchisor may still be required to provide disclosure in compliance with the state registration law.

¹³ The original FTC Rule stated that franchise sales are exempt if “the total payments . . . made during a period from any time before to within 6 months after commencing operation of the franchisee's business, is less than \$500.” The Amended FTC Rule states that franchise sales are exempt if “the total required payments, or commitments to make a required payment, to the franchisor or an affiliate that are made any time from before to within six months after commencing operations of the franchisee's business is less than \$500.” (emphasis added) The language under the Amended FTC Rule could be read to say that commitments to pay (e.g., promissory notes signed) during the first six months would count toward the \$500, even if the commitment required the franchisee to pay after the six month period expired.

¹⁴ See Bus. Franchise Guide (CCH) ¶ 6382.

¹⁵ Compliance Guide at 7.

We will not discuss every defined term in this section, but we will highlight certain critical definitions and issues raised by certain of the defined terms. We will discuss certain of these terms in more detail in Section III.F. of this paper.

1. **Confidentiality clause**

Item 20 of the Amended FTC Rule requires that franchisors disclose the existence of confidentiality clauses.¹⁶ The term is narrowly defined to include agreements or provisions that directly or indirectly restrict a current or former franchisee from discussing with a prospective franchisee the franchisee's experience as a franchisee in the franchise system. The Amended FTC Rule makes clear that confidentiality clauses do not include provisions that protect the franchisor's trademark or proprietary information like those that are typically found in franchise agreements or franchise termination agreements.¹⁷

2. **Financial performance representation**

The term "financial performance representation" replaces the term "earnings claim" in the original FTC Rule.¹⁸ The definition of financial performance representation is essentially the same as the definition of earnings claim under the original FTC Rule, with one exception. Under the Amended FTC Rule, cost information is not included in the definition of financial performance representation. Therefore, with one important caveat, cost information can be provided to prospective franchisees without including that information in Item 19. Interestingly, the FTC has taken the position that cost information provided outside of Item 19 as a percentage may only be provided as a percentage of total costs and not as a percentage of revenues (see further discussion *infra*).

3. **Franchise seller**

"Franchise seller" is a new defined term under the Amended FTC Rule and is broader than the term "franchisor." Franchise seller means "a person that offers for sale, sells, or arranges for the sale of a franchise" and includes not only the franchisor but also employees, agents, and contractors of the franchisor, including brokers, area representatives, and subfranchisors.¹⁹ The franchise seller(s) that sold a particular franchise is required to be listed in the Item 23 Receipt page as further discussed in Section III.F (13) below, and, importantly, the prohibitions under the Amended FTC Rule apply to franchise sellers.²⁰

4. **Franchisor**

The definition of franchisor includes any person who grants a franchise and participates in the franchise relationship, and it includes subfranchisors.²¹ The Amended FTC Rule requires

¹⁶ See 16 C.F.R. § 436.5(t)(7).

¹⁷ See *id.* § 436.1(c).

¹⁸ See *id.* § 436.1(e).

¹⁹ *Id.* § 436.1(j).

²⁰ See *id.* §§ 436.9, 436.5(w)(2).

²¹ See *id.* § 436.1(k).

all required information about the “franchisor,” including subfranchisors that “function[] as a franchisor by engaging in both pre-sale activities and post-sale performance”, be included in the FDD.²²

One issue that was raised with respect to this definition is whether area representatives (also known as area directors or development agents) are “subfranchisors” since they are typically involved in the franchise sales process and provide certain post-sale services to franchisees in their respective areas. The FTC clarified in FAQ #9 that an area representative or other development agent (regardless of the nomenclature) is not a subfranchisor, even if the area representative performs post-sale obligations on behalf of a franchisor unless the area representative is a party to the franchise agreement (or to another agreement involved in the outlet franchise).

5. Parent

The Amended FTC Rule adds and expands disclosure requirements with respect to “parents” of the franchisor in Items 1, 3, 4, and 21. We discuss each of the substantive disclosure requirements with respect to parents of the franchisor in Section III.F., but we note here that the definition of parent in the Amended FTC Rule is limited to an entity or entities that control the franchisor either directly or through one or more subsidiaries.²³

6. Signature

Franchisors are required to have the prospective franchisee’s “signature” on the Item 23 Receipt page to evidence that disclosure was properly provided. The term “signature” is broadly defined under the Amended FTC Rule as any “affirmative step to authenticate [one’s] identity” and includes handwritten signatures as well as a person’s use of electronic signatures, passwords, etc.²⁴

7. Written or in writing

Franchisors are required to provide prospective franchisees with a “written” FDD. The terms “written” and “in writing” are broadly defined as any “document or information in printed form or in any form capable of being preserved in tangible form and read” and includes word processed hard copies of documents as well as electronic versions of documents stored on CD-ROM, sent by e-mail, or posted on the Internet.²⁵

E. FTC and State Cover Pages

1. FTC Cover Page

The cover page required under Section 436.6 of the Amended FTC Rule (the “FTC Rule Cover Page”) must be the first page of the FDD. It should be set out in the order set forth in

²² See *id.* §§ 436.6(f), 436.5(u)(1)(v).

²³ See *id.* § 436.1(m).

²⁴ See *id.* § 436.1(u).

²⁵ See *id.* § 436.1(w).

Section 436.3, and must include each of the required statements in Section 436.3(e), word for word with no variation. If the franchisor intends to provide disclosure electronically, it may (but is not required to) include the statement set forth in Section 436.3(f) which advises the prospective franchisee that the FDD is available in another format.

We have highlighted a few important points regarding the FTC Cover Page and related matters below:

As noted above, the FTC Cover Page should be set forth in the exact order as the requirements appear in Section 436.3. Several state franchise examiners have gone so far as to require that the franchisor's logo be placed directly under the franchisor's name and contact information (in the order set forth in the Amended FTC Rule) as opposed to the upper left-hand corner of the FTC cover page, which was the common place in which the logo appeared in UFOCs prepared under the original UFOC Guidelines.

Section 436.3(e)(1) requires that the total initial investment range from Item 7 and the total amount that must be paid to the franchisor or its affiliate from Item 5 must appear on the FTC Cover Page. Examiners in certain states have required that the disclosure be made in one sentence and that specific disclosure of the Item 5 amounts should only list the total of all amounts described under Item 5 (i.e., it should not list each amount described in Item 5 separately) and if there are any cost items that are not included in the Item 7 or Item 5 disclosures, franchisors should not note this on the FTC Cover Page, but, instead, include a statement to that effect in Items 7 and/or 5.

The FTC has made clear that including on the FTC Cover Page the optional disclosure regarding alternative formats discussed above will not satisfy the pre-disclosure notice requirement regarding the format(s) in which the FDD is available, and that such pre-disclosure notice must be provided before giving the FDD to a prospective franchisee (e.g., in the franchise application, in a letter or other communication, or on the franchise opportunity web pages on the franchisor's website). A sample pre-disclosure notice regarding alternative formats in letter format is attached as Appendix C.

Some state examiners have expressed confusion regarding the issuance date that must be included on the FTC Cover Page. In some cases examiners have requested that the issuance date be deleted, reasoning that the FDD does not become effective in the registration state until the state approves the application and provides a notice of effectiveness, and, therefore the inclusion of the issuance date is "confusing." Clearly, the issuance date on the FTC Cover Page should not be removed since it is required to be included by the Amended FTC Rule and it relates to issuance in the non-registration states. However, the NASAA FDD Guidelines clarify this issue and indicate that franchisors may include a state effective date summary page (similar to the Uniform UFOC Addendum Page used in many UFOCs prepared under the original UFOC Guidelines) that lists the applicable registration state effective dates following the cover pages. In order to avoid confusion by the reader and the state examiners regarding the FDD issuance date, if the FDD contains a state effective date summary page, the following language should be included under or adjacent to the FDD issuance date appearing on the FTC Cover Page and on the State Cover Page: "See the following state effective date summary page for state effective dates."

2. State Cover Page

The NASAA FDD Guidelines require that a cover page (“State Cover Page”) be included as part of the FDD immediately following the FTC Cover Page.²⁶ Among other things, the State Cover Page requires a statement highlighting the fact that some franchise agreements require that franchisees meet certain conditions in order to renew the franchise after the initial term and certain “risk factors” relating to dispute resolution procedures, jurisdiction, and governing law provided for under the franchise agreement.

As with the FTC cover page, the language required to be included on the State Cover Page should be presented exactly as it appears (including capitalization format), and in the order set forth, in the NASAA FDD Guidelines. In addition to the standard risk factors required by the NASAA FDD Guidelines, state franchise examiners may require that additional franchise system-specific risk factors be added to the State Cover Page. If they do, those additional risk factors should be added following the standard risk factors.

Under the Amended FTC Rule, brokers are no longer required to be disclosed in Item 2. However, the NASAA FDD Guidelines require that the following legend be included on the State Cover Page if the franchisor engages third-party franchise brokers to offer the franchise:

We use the services of one or more FRANCHISE BROKERS or referral sources to assist us in selling our franchise. A franchise broker or referral source represents us, not you. We pay this person a fee for selling our franchise or referring you to us. You should be sure to do your own investigation of the franchise.

Not only must a franchisor include this legend on its State Cover Page when it engages the services of typical third-party franchise brokers, but this language should also be included on the State Cover Page if the franchisor has area representative/development agent relationships under which the area representative/development agent engages in franchise sales activities.

F. **Disclosure Items**

1. Item 1 (§ 436.5(a)) – The Franchisor, and any Parents, Predecessors, and Affiliates

The only significant difference between Item 1 of the Amended FTC Rule and Item 1 of the original UFOC Guidelines is that under the Amended FTC Rule, franchisors are now required to disclose the name and principal business address of any “parents.” Questions have been raised about what parent is required to be disclosed if the franchisor has multiple parents. For example, is the franchisor only required to disclose its “ultimate parent” or must it disclose all of its parents?

FAQ #16 addresses these issues. For the purposes of Item 1, a parent is required to be disclosed only if it directly or indirectly controls the franchisor (i.e., it “shape[s] the franchisor’s policies or control[s] franchise sales or operations”). A parent company that owns the franchisor but does not exert such control over the franchisor does not qualify as a “parent” for the

²⁶ NASAA FDD Guidelines, Section III.B.

purposes of Item 1, and, therefore, need not be disclosed in Item 1. Importantly, the Amended FTC Rule intentionally uses the plural “parents” in Section 436.5(a). Therefore, if the franchisor has more than one parent that controls the franchisor, all of those parents should be disclosed.

The determination of which parent(s) should be disclosed in Item 1 will, obviously, be made based on the particular structure and circumstances of each franchise system. The determination regarding whether a parent controls the franchisor (particularly the determination of whether some indirect control is being exerted) may not always be clear-cut. However, in most cases, it is better for franchisors to err on the side of disclosure, particularly given the relative innocuousness of the Item 1 parent disclosure requirement.

Another potential Item 1 issue relates to the inclusion of a list of defined terms in Item 1. Some franchisors have traditionally included a list of defined terms used throughout their disclosure document in Item 1 in an effort to make the defined terms easier to locate and the document more readable as a whole. The Amended FTC Rule does not prohibit the inclusion of a list of defined terms, but at least one state (Maryland) has taken the position that Item 1 should not contain such a list. Given the fact that registration states (including Maryland) often suggest ways to make FDDs more “user-friendly,” Maryland’s reasoning for requiring the deletion of lists of defined terms is not entirely clear. However, until such time that Maryland changes its position on this issue, franchisors that employ this drafting technique and file in Maryland should expect a comment from the state requiring that the list of defined terms be deleted and that the definitions be scattered throughout the FDD.

2. Item 2 (§ 436.5(b)) – Business Experience

The information required to be disclosed in Item 2 is almost identical to the information disclosed under the original UFOC Guidelines with two exceptions: brokers are no longer required to be disclosed, and, importantly, the individuals required to be disclosed in Item 2 are no longer limited to officer, directors, and employees of the franchisor.

The Statement of Basis and Purpose states that individuals with management responsibility for the sale or operation of the franchise must be disclosed regardless of that individual’s employer.²⁷ Therefore, employees of an affiliate of the franchisor that have management responsibility for the franchise must be disclosed in Item 2. The determination of whether an individual has “management responsibility” is fact-specific, but, again franchisors should err on the side of disclosing an individual if the question is close.

Additionally, although franchise brokers are no longer required to be disclosed in Item 2 under the Amended Rule, certain types of brokers that have management responsibility relating to the franchise (e.g., area representatives/development agents) may need to be disclosed in Item 2.

3. Item 3 (§ 436.5(c)) – Litigation

The Item 3 disclosure requirements in the original UFOC Guidelines have been expanded in two material respects in the Amended FTC Rule. First, litigation for certain parents of the franchisor must be disclosed. Pending and past litigation to which a parent of the franchisor has been a party must be disclosed if that parent “induces franchise sales by

²⁷ Statement of Basis and Purpose at 15467.

promising to back the franchisor financially or otherwise guarantees the franchisor's performance" (injunctions or restrictive orders or decrees resulting from pending or concluded public agency actions to which a parent is subject are also required to be disclosed, but only with respect to parents that guarantee the franchisor's performance).²⁸

The determination of whether parent company litigation must be disclosed is critical, particularly in franchise systems that have a large parent company or a parent that is a public company that may have significant amounts of litigation that fall into the categories of discloseable litigation. In determining whether litigation of a parent is required to be disclosed, it is important to first analyze whether a particular parent of the franchisor falls within the general definition of "parent" under the Amended FTC Rule. Remember, the entity must directly or indirectly control the franchisor in order to fall within the Amended FTC Rule's definition of a parent.

The next step in the analysis is to determine whether the parent "financially backs" the franchisor or guarantees the obligations of the franchisor. The Amended FTC Rule does not define what "financial backing" means, but FAQ #16 and the Compliance Guide provide some guidance. FAQ #16 states that financial backing in the context of Item 3 means "promises that a parent may make to ensure that the franchise system is and remains on stable financial footing." If the parent promises to provide the franchisor with cash or extend credit or pay debts on behalf of the franchisor, if needed, those promises may be deemed financial backing.

Where there is a formal commitment to provide financial backing, this analysis should be straightforward. Situations in which there is an informal arrangement under which the parent provides a financial backstop or in which there may be *de facto* financial backing (*i.e.*, the parent bears a disproportionate share of overhead) may be more difficult to analyze. However, if a franchisor merely associates itself with a large, strong parent company (*e.g.*, Best Value Hotels, an American Hotels company (where Best Value Hotels is the franchisor and American Hotels is the parent)) without more, the parent should not be deemed to be financially backing the franchisor.

FAQ #16 also clarifies that "guaranteeing performance" refers to "promises made between the franchisor's parent and the franchisor for the benefit of franchisees or from the franchisor's parent directly to the franchisees." The most common situation in which this occurs is where the parent agrees to meet the obligations of the franchisor under the franchise agreement if the franchisor is unable to perform its obligations.

If the franchisor has no parent or affiliate that guarantees its obligations or provides financial backing, it should consider including a disclaimer similar to the following in its franchise agreement:

Franchisee acknowledges that it is relying solely on ABC Franchise Company, LLC, and not on any affiliated entities or parent companies related to ABC Franchise Company, LLC, with regard to Franchisor's financial and other obligations under this Agreement, and no employee or other person speaking on behalf

²⁸ Consistent with the original UFOC Guidelines, litigation involving certain non-parent affiliates must also be disclosed, including litigation of affiliates that financially back the franchisor or guarantee the franchisor's performance or non-parent affiliates that offer franchises under the franchisor's principal trademark. See 16 C.F.R. § 436.5(c)(1).

of, or otherwise representing, ABC Franchise Company, LLC, has made any statement or promise to the effect that any affiliated entities or parent companies guarantee Franchisor's performance or financially back Franchisor.

Such a disclaimer would not relieve the franchisor of the requirement to disclose litigation of a parent or affiliate if the parent or affiliate, in fact, guarantees its obligations or provides financial backing, but it could be helpful to show that the franchisee should not have relied on any statement to the contrary if an issue ever arises in this respect.

The second significant additional disclosure obligation under Item 2 of the Amended FTC Rule is the requirement to include a disclosure of material litigation initiated by the franchisor against franchisees involving the franchise relationship. The critical points with respect to the new franchisor-initiated action disclosure are: (a) this disclosure may be made in summary fashion (i.e., the individual suits can be listed under common headings (e.g., "royalty suits" or "suits to enforce standards compliance") without providing a full description of the action) and (b) the disclosure is to include only actions filed in the franchisor's most recently completed fiscal year and is not required to be updated during the year. One caveat: if a franchisee that is the subject of an action that was initiated by the franchisor files a counterclaim against the franchisor that is otherwise required to be disclosed in Item 3, that action is essentially converted from a franchisor-initiated action for which summary disclosure was appropriate to an action which must be fully-disclosed as if it were initially filed by the franchisee.

Litigation involving individuals listed in Item 2 must be disclosed. This is not a change from the original UFOC Guidelines requirements, but, as discussed above, the list of individuals who must be disclosed in Item 2 has been broadened to include non-employees with management responsibility for the franchise. Therefore, additional litigation may need to be added to Item 3 if individuals with discloseable litigation have been added to Item 2.

Finally, although not specifically contemplated in the Amended FTC Rule, litigation in foreign jurisdictions should be disclosed. Although the Commentary to the original UFOC Guidelines does not apply to the Amended FTC Rule, that Commentary states that Item 3 is not limited to litigation filed in the United States.²⁹ Since the Amended FTC Rule generally tracks the UFOC Guidelines, it is reasonable to assume that the FTC adopted this position, and it is prudent to include foreign litigation.

4. Item 4 (§ 436.5(d)) – Bankruptcy

Under the original UFOC Guidelines, disclosure of parent bankruptcies was not required. However, under the Amended FTC Rule, parent bankruptcies are required to be disclosed. Importantly, there is no qualification, as in Item 3, regarding the parents for which bankruptcies must be disclosed, and, therefore, bankruptcies of all parents of the franchisor must be disclosed in Item 4.

Although the general definition of parent in Section 436.1 applies in Item 4, franchisors should carefully consider the issue of whether a parent controls the franchisor in this context. Excluding bankruptcies of a parent on the basis of a determination that the parent does not

²⁹ UFOC Guidelines Commentary, 1994 Issue #12, Bus. Franchise Guide (CCH) ¶ 5790.

control the franchisor could present a risk. Although arguments may be made to the contrary, a disgruntled franchisee could argue that any parent has at least an indirect ability to control the franchisor, and that a bankruptcy, even of a remote parent, was material to its determination to purchase the franchise and that the exclusion of the bankruptcy disclosure was a material violation of the Amended FTC Rule. As noted previously, when considering whether to disclose parent bankruptcies, it's likely better to disclose if the issue of control is unclear.

Finally, franchisors must remember that under the Amended FTC Rule, bankruptcies filed in foreign jurisdictions must be disclosed.

5. Item 7 (§ 436.5(g)) – Estimated Initial Investment

Item 7 remains essentially the same as the Item 7 in the original UFOC Guidelines. However, we note one technical formatting issue that has drawn comments from numerous state examiners and one more substantive point.

First, state examiners have been particularly keen to point out that the title of Item 7, "Estimated Initial Investment" and the title of the Item 7 chart, "Your Estimated Initial Investment," must appear adjacent to each other in Item 7. Although the appearance is somewhat awkward, the following format must be followed:

Item 7
Estimated Initial Investment

YOUR ESTIMATED INITIAL INVESTMENT

[Item 7 Chart]

Additionally, the Compliance Guide addresses the issue of the effect of sales of company-owned units on the Item 7 estimates. The price paid by a franchisee in purchasing a company-owned outlet need not generally be reflected in Item 7. However, if the investment made by a franchisee that purchased a company-owned outlet in the prior year exceeds the high end of the Item 7 initial investment range, a footnote should be included in Item 7 which states the highest amount invested by a franchisee that purchased a company-owned outlet.

6. Item 8 (§ 436.5(h)) – Restrictions on Sources of Products and Services

Item 8 of the Amended FTC Rule essentially tracks Item 8 of the original UFOC Guidelines. However, if an officer of the franchisor owns an interest in any supplier of the franchise system from which franchisees are required to purchase products or services, that fact and the name of the supplier must now be disclosed in Item 8. It is important to note that there is no requirement to disclose the name of the officer or the level of ownership—only the fact that an officer owns an interest in the supplier and the name of the supplier are required to be disclosed. This disclosure requirement applies to any supplier from which franchisees are required to make purchases, including entities affiliated with the franchisor and publicly-traded companies. However, it generally would not be triggered by ownership of units in diversified mutual funds that might hold investments in a supplier.

The FTC responded to the question of whether the Amended FTC Rule requires disclosure regarding ownership of *de minimis* interests in a supplier by an officer of the

franchisor in FAQ #18. The FTC confirmed in that FAQ that *de minimis* ownership interests would not be material in a franchisee's decision to invest in the franchise, and, therefore, would not be discloseable. However, the FTC refused to state a threshold level of ownership, above which would be considered material. The FTC suggested that the more "direct" the ownership is, the more likely that the interest would be material, and the more "indirect and attenuated" the ownership is, the more likely that the interest would be immaterial.

Consistent with the original UFOC Guidelines, Item 8 requires the disclosure of certain payments by system suppliers to affiliates of the franchisor. The Compliance Guide indicates that payments made by suppliers to a franchisor-administered advertising fund or a trademark-specific franchisee association or other third-parties controlled by the franchisor or its affiliate must be disclosed in Item 8. However, payments made to independent third parties, including independent advertising cooperatives, need not be disclosed. The FTC has not addressed whether payments made to independent advertising cooperatives in which the franchisor participates and has voting rights would need to be disclosed, but as long as the franchisor does not have voting control of the cooperative, payments to such a cooperative should not be required to be disclosed.

7. Item 11 (§ 436.5(k)) – Franchisor's Assistance, Computer Systems, and Training

Item 11 of the Amended FTC Rule differs significantly in several respects from Item 11 of the original UFOC Guidelines. There are no particularly "thorny" new disclosure issues in Item 11, but there are some general guidelines that should be kept in mind when drafting Item 11.

First, the order of the disclosures in Item 11 has changed. Item 11 should be presented in the order set forth in Section 436.5(k).

Second, the detailed computer system disclosures that were required by the original UFOC Guidelines are no longer required. All that is required with respect to computer systems is a non-technical description of the required systems generally and the types of data to be generated or stored in the systems. Additionally, the cost of the systems; any obligation of the franchisor, its affiliate, or a third-party to maintain, upgrade or repair the systems; any requirement for the franchisee to upgrade the system; and the annual cost of optional or required maintenance, upgrading or support contracts must be disclosed in Item 11.

Finally, the headings of the training chart have been revised so that the location of training must be included in the chart, and the materials used in training are no longer in the chart but are now required to be disclosed in narrative format.

8. Item 12 (§ 436.5(l)) – Territory

Item 12 includes a new requirement to include the following statement if the franchisor does not grant an exclusive territory:

You will not receive an exclusive territory. You may face competition from other franchisees, from outlets that we own, or from other channels of distribution or competitive brands that we control.

Some commentators have questioned whether this disclaimer is required in any circumstance in which the franchisor does not grant complete exclusivity, which would be almost every franchisor that grants territorial protection since most franchisors that grant territorial protection reserve some rights in the franchisee's protected area, including the right to offer products and services that are the subject of the franchise through alternative distribution channels or under different brands. The FTC clarified in a recent FAQ (#25) that a typical reservation of rights provision which permits the franchisor "to make sales in the territory through alternative channels of distribution or competitive brands" does not trigger the requirement to include the statement. The statement is only required in circumstances where the franchisor does not commit to refrain from establishing "company-owned or franchised outlet[s] selling the same or similar goods or services under the same or similar trademarks or service marks." Otherwise, the statement should not be included in Item 12.

Although most franchisors fully described in their UFOCs the reserved rights provisions contained in their franchise agreements, Item 12 now specifically requires the disclosure of rights in the protected territory that the franchisor reserves both with respect to the distribution of products and services under the franchisor's principal trademark and other trademarks through other channels of distribution, including the Internet, catalog sales, telemarketing, or other direct marketing. It is important to specifically address whether the franchisor reserves rights to engage in distribution through these alternative channels, whether or not the franchisor grants any territorial protection.

9. Item 17 (§ 436.5(q)) – Renewal, Termination, Transfer, and Dispute Resolution

Item 17 now requires franchisors to disclose the terms under which a franchise agreement will be renewed, with a particular emphasis on whether the terms of the agreement – after renewal – might be "materially different" from those in the original form of agreement.³⁰ In adopting this requirement,³¹ the FTC observed that:

Especially in an age of new technologies and changes in franchise marketing, renewal contracts may be significantly different from original contracts that franchisees signed 10 to 20 years ago. A renewing franchisee, for example, may reasonably wish to see Item 20 closure rates for franchises operating under the new franchise agreement. Accordingly, the Commission concludes that where the franchise agreement contains terms and conditions materially different from the original agreement, the renewing franchisee needs advance disclosures in order to make an informed renewal decision.³²

More recently, the Commission's staff and the NASAA FDD Disclosure Guidelines³³ provided sample disclosures for Item 17 of the FDD that dispense with the paragraph of

³⁰ See, e.g., *Test Services, Inc. v. The Princeton Review, Inc.*, Bus. Franchise Guide (CCH) ¶ 13,450 (D. Colo. 2005) (upholding requirement that franchisee execute franchisor's then-current form of franchise agreement as a condition to franchisee's exercise of option to renew initial term of franchise agreement).

³¹ 16 C.F.R. § 436.5(q)(3).

³² Statement of Basis and Purpose at 15467, 15496.

³³ NASAA FDD Guidelines, Section VII.

citations to state relationship laws – which had been a staple of UFOCs since that language was inserted in the sample answers to the 1993 UFOC Guidelines (but not required under the Guidelines themselves).

10. Item 19 (§ 436.5(s)) – Financial Performance Representations

Mandatory language. The FTC has specified in Section 436.5(s) certain language that must appear in Item 19. These include:

First, a mandatory statement explaining that the FTC Rule allows a franchisor to provide a financial performance representation.

Second, if a franchisor does not make a financial performance representation, there is a mandatory paragraph to add to explain that fact.

Third, if a franchisor makes a financial performance representation, it must make a required statement regarding the availability of written substantiation for the financial performance representation, such as the following:³⁴

We will make available to you, upon reasonable request, written substantiation for the financial performance representation in this Item 19.

Fourth, if a franchisor makes a financial performance representation, it must also include a “clear and conspicuous” statement that a new franchisee’s results may differ from those stated in the financial performance representation, such as the following:

A new franchisee’s individual financial results may differ from the results stated in the financial performance representation provided in this Item 19.

Expenses. An interesting development occurred in connection with interpreting Item 19 of the new FDD guidelines. The Commission seems to have made clear that representations concerning expenses would not be deemed financial performance representations. Yet, in informal settings, the FTC’s staff has expressed caution and suggested a narrower view of the standard, indicating that while providing expense information in absolute dollar figures (e.g., your cost of goods sold (COGS) will be approx. \$50-75,000 per month) would not be a financial performance representation, putting that data into a percentage (e.g., COGS will be approx. 15-20% of gross sales) would still be deemed a financial performance representation.

As background, the Commission’s Statement of Basis and Purpose discussed whether disclosure of operating expense data, by itself, constitutes an earning claim, as follows:

Most commenters who responded on this issue felt that disclosures of expense information should not fall within the definition [of a financial performance representation]. Some, however, sought additional clarification. For example, the [Illinois Attorney General’s office] urged the

³⁴ Section 436.9(c) backs up this disclosure requirement by prohibiting a franchisor from making a financial performance representation unless it has a reasonable basis and written substantiation for the claim at the time when the franchisor makes the claim. Likewise, Section 436.9(d) also prohibits a franchisor from failing to make written substantiation available to a prospective franchisee upon reasonable request.

Commission to modify the definition of “financial performance representation” to expressly exclude expense disclosures mandated in Items 5–7 of the final amended Rule (initial fees, ongoing costs, and initial investment), offering the following additional sentence: “Expenses required in Items 5, 6, and 7 of the disclosure document are not to be considered performance claims and do not contradict Item 19 requirements.” Others went further, arguing that the dissemination of any expense information should not trigger the Item 19 disclosure requirements.³⁵

The footnotes to the foregoing passage include a reference to a comment submitted on this point by one commentator, who the FTC cited as having “argu[ed] that expense disclosures inevitably will lead prospective franchisees to extrapolate earnings without the protection of an Item 19 disclosure.”³⁶ Thus, it is notable that the Commission appeared to dismiss the comment by immediately following with the conclusion that:

The Commission is persuaded that expense information alone is insufficient to enable prospective franchisees to gauge their potential earnings with any degree of specificity that could rise to the level of a financial performance claim. The Commission explained in the Franchise NPR and now reiterates here that mere disclosure of cost information does not, in its view, constitute a financial performance representation triggering Item 19 disclosure obligations. The Commission intends that the explanation that mere expense disclosures alone do not constitute a financial performance representation, coupled with the deliberate omission of any mention of expense information from section 436.1(e) of the final amended Rule, will be enough to address this issue.³⁷

In 2008, the FTC’s staff confirmed its view, in the Compliance Guide, that disclosure of more than just raw expense figures might still constitute a financial performance representation:

The presentation of cost or expense data alone is not a financial performance representation. Accordingly, the disclosure of fees, required purchases, and expenses reported in Items 5 through 7 ordinarily will not constitute a financial performance claim that would have to be disclosed in Item 19. Nevertheless, a presentation of cost data, coupled with additional sales or earnings figures, from which prospective franchisees could readily calculate average net profits, is a financial performance representation, and does trigger the Item 19 disclosure obligation.³⁸

The Rule defines the term “financial performance representation” in Section 436.1(e) as: “any representation, including any oral, written ... to a prospective franchisee ... that states,

³⁵ Statement of Basis and Purpose at 15456 (footnotes omitted). In the Compliance Guide, the FTC staff confirmed that expenses disclosed in Item 7 do not constitute earnings claims. See Compliance Guide at 48 n. 13.

³⁶ Id. at 15456 n. 106.

³⁷ Id. at 15457 (footnotes omitted).

³⁸ Compliance Guide at 131.

expressly or by implication, a specific level or range of actual or potential sales, income, gross profits, or net profits.” On its own, a statement about costs expressed in absolute dollar terms appears to confer no more information about “a specific level or range of actual or potential sales, income, gross profits, or net profits” than a statement of costs that is expressed as a mere percentage of an unknown revenue figure.

Media Claims. In Section 436.1(e), the Commission retained the general definition of what constitutes an earnings claim – which included “general media” claims. Among other things, the Commission confirmed some important points in the Statement of Basis and Purpose. These include the general provision that a financial performance representation may be made if information is disseminated in the general media. However, the FTC also made clear that certain types of information that are quite prevalent in the 21st Century do not fall within the category of “media claims,” pointing specifically to links on a franchisor’s website to press releases, interviews, articles, financial statements (especially those filed with the SEC), and other such information, so long as this information is not directed to the attention of a prospective franchisee.³⁹ Nevertheless, a franchisor should avoid having a link to this kind of information from the franchise portion of its website.

11. Item 20 (§ 436.5(t)) – Outlets and Franchisee Information

As discussed above, Section 436.5(t)(7) includes a new requirement that franchisors disclose “whether franchisees signed confidentiality clauses during the last three fiscal years.” While the sample answer provided in the Amended FTC Rule gave a hint as to the scope of this requirement, the FTC Staff in the Compliance Guide further clarified the point. In the Compliance Guide, the FTC Staff made clear that the Section 436.5(t)(7) disclosure requirement is limited to confidentiality clauses that preclude a franchisee or former franchisee from discussing the terms of the franchisee’s relationship to the franchisor:

The requirement to disclose confidentiality agreements is narrow. As noted, it specifically is limited to agreements that restrict a current or former franchisee from discussing his or her personal experience as a franchisee in the franchisor’s system. Thus, for example, if a franchisee is also employed by the franchisor as a manager, a confidentiality agreement prohibiting the franchisee from discussing her experience as a manager (as opposed to a franchisee) would not trigger this disclosure. Further, a confidentiality agreement that would bar a franchisee from speaking with individuals other than a prospective franchisee – such as competitors or trade press – would not trigger this disclosure obligation. This obligation would also not be triggered if a franchisee is restricted from discussing only the specific terms of a settlement, but is otherwise free to discuss his or her experience – including having a dispute with the franchisor.⁴⁰

To eliminate ambiguity, a franchisor wishing to include a confidentiality clause in a settlement agreement, but not wanting to have to disclose that its franchisees might be subject

³⁹ Statement of Basis and Purpose at 15457–58. See also Staff Advisory Opinion 04-2 (Jan. 2004) (reprinted at Bus. Franchise Guide (CCH) ¶ 6522) for a more detailed discussion of media claims that appears to be consistent with the approach taken by the FTC when it issued the Amended FTC Rule in 2007.

⁴⁰ Compliance Guide at 108.

to confidentiality clauses, can make clear that any such confidentiality clause is limited in scope. For example, disclosure under Section 436.7(t)(7) would seem unnecessary if the confidentiality clause added language that stated:

This Section [x] precludes Franchisee from discussing the terms of this Agreement and the settlement reflected herein, but nothing in this Agreement prevents Franchisee from truthfully answering questions from interested parties about Franchisee's relationship to Franchisor.

12. Item 21 (§ 436.5(u)) – Financial Statements

Phase-In of Audited Financial Statements. One of the issues facing start-up franchisors is whether they must have audited financial statements when their operations are only days or weeks old. The FTC Rule calls for only an unaudited opening balance sheet from a new, start-up franchisor, during its first partial fiscal year, and confirms the FTC's past practice of permitting the phasing-in of audited financial statements.⁴¹ Use of the phase-in has practical application, since an opening balance sheet – if properly prepared – is a relatively simple and efficient document for an accountant or in-house CFO to prepare. Elaborating on this point, the FTC's staff noted, in FAQ #11: "In short, balance sheets must be in a format that conforms as closely as possible to audited statements prepared under GAAP. Further, to avoid any confusion with an audited balance sheet, the franchisor must clearly and conspicuously note that the balance sheet is unaudited."

In the Statement of Basis and Purpose, the FTC acknowledged the while its approach followed the lead of several states, not all states would allow use of an unaudited opening balance sheet for a start-up franchisor.⁴² The FTC noted that California and Illinois allowed some franchisors to phase-in audited financial statements but that Minnesota and Virginia would require audited financial statements. While the NASAA FDD Guidelines are identical to the FTC on this issue,⁴³ as of the date of this writing, the authors are not yet aware of the states' final conclusions on this issue.

Use of U.S. Generally-Accepted Auditing Standards. In the Statement of Basis and Purpose, the FTC indicated that accounting firms would need to conduct their audits according to U.S. generally accepted audited standards ("GAAS"). However, accounting firms have already begun to adopt a different standard for auditing; instead of using GAAS, auditors have been using rules promulgated by the Public Company Accounting Oversight Board ("PCAOB"), which was established under Section 101 of the Sarbanes-Oxley Act. The PCAOB auditing standards were approved by the SEC and incorporate (and exceed) GAAS. In 2004, the SEC adopted PCAOB Auditing Standard No. 1, which "require[s] registered public accounting firms to refer to the standards of the PCAOB in their audit reports, rather than to U.S. generally accepted auditing standards...." ⁴⁴ This should not raise any practical concerns, though, as the

⁴¹ 16 C.F.R. § 436.5(u)(2).

⁴² Statement of Basis and Purpose at 15511 n. 671.

⁴³ NASAA FDD Guidelines, Section VII.

⁴⁴ See SEC Release No. 34-49707; File No. PCAOB-2003-10; issued May 14, 2004 (available at <http://sec.gov/rules/pcaob/34-49707.htm>).

FTC's staff, in footnote 4 to FAQ #17, signaled that it would "interpret the Franchise Rule's accounting, as well as auditing standards, consistent with SEC practice."

Foreign Franchisors. Franchisors based outside the U.S. have, in recent years, encountered difficulties using their financial statements because of concern over whether the auditors they employ meet the Item 21 standards. In some instances, state examiners have raised questions as to whether Canadian chartered accountants satisfied the standard because their title differs from the nomenclature used in U.S. accounting firms, i.e., "certified public accountant." In other instances, concerns have been expressed over whether the term "independent" was included as part of the title of a Canadian chartered accounting firm.

The FTC staff sought to clarify this point in FAQ #17. First, the FTC staff explained it "do[es] not interpret use of the term "CPA" in the Amended FTC Rule as permitting only an American CPA to audit financial statements." Elaborating further, FAQ #17 goes on to conclude that:

Commission staff believes that foreign accountants or accounting firms may audit financial statements for Franchise Rule purposes consistent with PCAOB and SEC policies. That means that all foreign accounting firms wishing to prepare audited financials under the Franchise Rule must: (1) be registered with PCAOB; and (2) recently audited one or more financial statements that have been filed and accepted by the SEC.

The FTC's final position reflected a more flexible approach than had been earlier considered,⁴⁵ in particular the Commission chose not to adopt a proposal that a franchisor could use only financial statements prepared by a U.S. accounting firm, applying U.S. GAAP. In the Statement of Basis and Purpose, the FTC concluded that:

Given the absence of any indication in the record that foreign accounting principles are inherently deceptive, flexibility in preparing financial statements is warranted. As long as the SEC would permit foreign accounting standards or foreign financial statements, we see no policy reason to differ. This is particularly true of financial statements prepared according to Canadian GAAP, which receives more lenient treatment under SEC law.⁴⁶

Use of U.S. Generally-Accepted Accounting Practices. American businesses will face, in the near future, the introduction of changes to U.S. GAAP to harmonize those standards with International Financial Reporting Standards ("IFRS"). The U.S. Financial Accounting Standards Board (or FASB) entered into a memorandum of understanding in October 2002 with the International Accounting Standards Board toward the goal of seeking greater convergence of U.S. and international accounting standards. This process will, eventually, lead to greater harmony, and fewer differences, between U.S. GAAP and standards used outside the U.S.

In January 2008 the SEC took a step in this direction by adopting rules permitting foreign private issuers to file financial statements with the SEC, prepared in accordance with IFRS, but

⁴⁵ See FTC Staff Advisory Opinion 02-4 (November 18, 2002).

⁴⁶ Statement of Basis and Purpose at 15510 n. 660.

without the need for reconciliation to U.S. GAAP.⁴⁷ Again, the FTC anticipated that this development might occur, building flexibility into the Rule. In the prefatory paragraph of Item 21 the FTC mandated that franchisors must include in their FDDs “financial statements prepared according to United States generally accepted accounting principles, as revised by any future United States government mandated accounting principles, or as permitted by the Securities and Exchange Commission.”

Parent Financial Statements. Section 436.5(u)(v) of the FTC Rule requires franchisors to disclose separate financial statements for a parent if that parent “commits to perform post-sale obligations for the franchisor or guarantees the franchisor’s obligations.” In FAQs #4 and #16, the Commission’s staff elaborated on this requirement. Specifically in FAQ #16, the FTC staff confirmed its view that the parent financial disclosure requirement is triggered only if the parent either guarantees the franchisor’s obligations or otherwise makes a “formal commitment” and that the requirement does not apply merely because the parent performs certain back office services for the franchisor. The FTC’s staff further explained that:

The Item 21 parent financials disclosure is intended to cover formal arrangements between the parent and franchisor for the benefit of franchisees or formal arrangements directly between the parent and franchisees. The performance of post-sale obligations by a parent’s employee for the benefit of franchisees does not trigger the Item 21 parent financial disclosures, absent a formal commitment or guarantee on the part of the parent to perform.⁴⁸

13. Item 23 (§ 436.5(w)) – Receipts

Section 436.5(w) requires that franchisors provide the name of “each franchise seller” in the receipt. This introduces to the FDD a new concept that has caused considerable discussion and raised concern about how, as a practical matter, to comply with the requirement.

The term “franchise seller” is defined in Section 436.1(j) to include the franchisor’s “employees, representatives, agents, subfranchisors, and third-party brokers who are involved in franchise sales activities.” Read together, that definition and the Item 23 requirement pose a practical problem that the FTC staff acknowledged in FAQ #15 – when the FDD is furnished, neither the franchisor nor the prospect may know the identity of every individual who may play a significant role in the sales process before closing. In FAQ #15, the FTC’s staff suggested several methods that could be used to record the names of franchise sellers, such as going back to the receipt and writing in those individuals’ names at closing, stapling the other franchise sellers’ business cards to the receipt, or possibly even recording their names in other documents (e.g., a letter, a compliance questionnaire, etc.). The FTC’s staff also recommended giving the franchisee a copy of the pages containing the record of those franchise sellers’ names. The FTC’s staff made clear that whatever method is chosen to record the ‘franchise seller’ information, that disclosure will not re-start the 14 day disclosure period.⁴⁹

⁴⁷ 73 Fed. Reg. 986 (2008) (“Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP”).

⁴⁸ FAQ #16, n. 6.

⁴⁹ FAQ # 23.

In FAQ #23, the FTC staff again addressed the receipt issue. There, staff commented that “Item 23 places the burden on the franchisor, not on a prospective franchisee, to identify franchise sellers on the receipt page” (or, ostensibly, in another setting as suggested by the FTC staff in FAQ #15). The FTC’s staff indicated that while the franchisor may request the franchisee’s assistance in identifying “franchise sellers,” the franchisor should “know which of its officers and employees will have significant contact with the prospect” during the period before the franchise agreement is signed. FAQ #23 specifically recognized that a franchisor is not required to identify every single franchise seller with whom a particular potential franchisee may have had some contact.

Given the real-world difficulty that some franchisors face in simply obtaining prospective franchisees’ signatures on receipts, the new requirements imposed under Item 23 are a complicating factor that can be, for some franchisors, a daunting prospect. While the FTC and its staff have recognized these practical difficulties, navigating those waters may still be troublesome. One practical approach would be to list in the pre-printed Item 23 receipt the senior franchise sales executives and leave space for a franchisee to fill in when the receipt is first signed the names of additional “franchise sellers” with whom they have already had significant contact. At closing, a separate statement can be prepared to identify any other ‘franchise sellers’ with whom the franchisee had significant contact, and that statement can be signed by the franchisee just before the franchise agreement is signed.

G. Prohibitions

Disclaimers. Section 436.9(h) prohibits a franchisor from disclaiming, or requiring a franchisee to waive reliance upon, any statement made in the FDD. In effect, this provision is a ban on all-encompassing integration clauses in franchise agreements. There has been considerable and thoughtful discussion on this point on the ABA Forum’s listserv, with some practitioners observing that Section 439(h) represents the FTC’s first regulation of the substance of the franchise relationship. Whatever the case may be, franchisors need to strike the proper balance between complying with this requirement and drafting an appropriate integration clause, which is consistent with normal and prudent contract drafting. Language along the following lines has been found acceptable by state examiners:

xx.1 Entire Agreement. This Agreement and the exhibits referred to herein constitute the entire, full, and complete Agreement between Franchisor and Franchisee concerning the subject matter hereof, and supersede all prior agreements, no other representations having induced Franchisee to execute this Agreement. The parties acknowledge and agree that they relied only on the words printed in this Agreement in deciding whether to enter into this Agreement (except as stated in the following sentence). Nothing in this Section xx.1 is intended as, nor shall it be interpreted to be, a disclaimer by Franchisor of any representation made in its Franchise Disclosure Document (“FDD”), including the exhibits and any amendments to the FDD.

H. General Terms

E-Disclosure. The Amended FTC Rule now makes clear that e-disclosure is permitted. In the Statement of Basis and Purpose, the Commission states that “the final amended Rule also promotes efficiency and reduces compliance costs by enabling franchisors to use their own judgment in deciding how to disseminate disclosure documents. For example, part 436 permits franchisors to furnish disclosures electronically through a variety of media, including CD-ROM,

Internet website, and email.”⁵⁰ The FTC requires franchisors to provide certain pre-disclosure information to prospective franchisees about how disclosure will be given (this is discussed earlier and a sample letter is provided in Appendix B).

There are basically four standards for providing e-disclosure under the Amended FTC Rule. Notably, only parts “1” and “2” below are unique to e-disclosure. These standards are:

1) Pre-Disclosure Notification. Under Section 436.6(g), franchisors must, before they furnish the FDD, advise the prospect of the formats in which the FDD is available and other information, including the requirements for obtaining the FDD in a particular format, as well as conditions necessary to review the FDD in that format. This information can be provided in any manner that the franchisor wishes, as earlier noted, but must be in writing and before the FDD is delivered. (See Appendix A.)

2) Delivery. Franchisors must prepare and deliver their electronic FDDs in one simple file, without any extraneous content such as external hyperlinks (but see the discussion of e-Receipts, below in this paper). There are no limits on how to deliver the FDD – it can be provided in tangible media (such as a CD or a thumb-drive), by e-mail, or by sending the FDD over the web (from the franchisor’s website or from a commercial website).

3) Proof. The franchisor must be able to prove that it delivered – and that prospects who enter into a franchise agreement received – the FDD. Franchisors should retain copies of outgoing letters, e-mails, or web messages that reflect the transmittal, downloading, or other means by which the franchisor provided the FDD.⁵¹ If a prospect is a corporation, LLC, or some other entity, then delivery of the FDD to one representative of the entity (e.g., a corporate officer) is sufficient.⁵²

4) Record-keeping. Franchisors must keep a copy of each materially different version of their FDD for three full fiscal years after issuing the FDD.⁵³

⁵⁰ Statement of Basis and Purpose at 15452.

⁵¹ The NASAA Statement of Policy Regarding Electronic Delivery of Franchise Disclosure Documents requires that the franchisor be able to prove receipt or else its authority to send the disclosure by electronic means is deemed (in effect, retroactively) ineffective. This raises several concerns. First, the purported grant of authority to provide disclosure by electronic means seems unnecessary in view of federal law in this area, specifically, the E-SIGN Act, 15 U.S.C. § 7001 et seq. The FTC recognized this in 2007 when it issued the Statement of Basis and Purpose. In the SBP at 15514, the FTC reversed its earlier position, noting that E-SIGN effectively eliminated barriers in federal and state law to a broad range of electronic documents, including franchise disclosure documents. Consequently, the FTC recognized that its original proposal to regulate e-disclosure (in what was draft § 436.7) was not only unnecessary but also pre-empted by E-SIGN. Second, the NASAA policy sets up different treatment for the provision of paper and electronic disclosure, and by imposing a more stringent standard on e-disclosure, discriminates against electronic disclosure - which as the FTC observed in the Statement of Basis and Purpose (at 15517–18), is inconsistent with the non-discrimination provisions of E-SIGN. E-SIGN specifically preempted almost all state and federal laws and regulations that limited use of electronic signatures, agreements, or records and, while E-SIGN does not mandate that contracts and disclosures be given in electronic form, it eliminates the barriers to doing so. 15 U.S.C. § 7001.

⁵² Statement of Basis and Purpose at 15464.

⁵³ 16 C.F.R. § 436.6(h) (this requirement applies whether the franchisor provides its FDD in paper or electronic form).

Franchisors also must retain, for at least three years, a copy of the signed FDD receipt for prospects that enter into a franchise agreement.⁵⁴

E-Receipts. Of particular interest to practitioners and franchisors is that the FTC staff has confirmed that it has no objection to electronic receipts.⁵⁵ This confirmation came in the form of FAQ #15, in which the Commission's staff expressed its informal approval of unconventional methods for obtaining FDD receipts. In sum, staff concluded that two methods were acceptable and cautioned against a third.

One of the innovative methods for e-receipts deemed acceptable by the FTC staff was an external link from the Item 23 page in the FDD to a “plain vanilla” receipt webpage. Such a webpage would have very limited content: (a) the same text as in the FDD Item 23 receipt (because the FTC considers that page to have a consumer education element); (b) pull-down boxes and blanks that a prospect can complete to provide information about his/her/its identity (so that the franchisor can connect that receipt to a specific prospect); and (c) no additional content or secondary links (e.g., no link to the franchisor’s website). In those circumstances, the FTC staff concluded that it would allow the external link and that a receipt generated by such an electronic confirmation of receipt would suffice for Item 23 purposes. An effective use of this method for providing receipts would probably include an e-mail generated by the franchisor’s website – to both the prospect who completed the web receipt as well as the franchisor’s internal designee – containing the same text as was on the receipt page (including the Item 23 text) so that both parties will have confirmation that the receipt was generated.

The second approach that the FTC staff sanctioned was a hot icon allowing the prospect to print-out the Item 23 receipt page on their own computer. This seems, in the broad scheme of things, to be an obvious and easy approach.

Finally, the staff commented in FAQ #15 that in its view, a separately-provided receipt (e.g., a page included in the envelope with a CD), even if completed and signed, would not suffice to establish receipt of the FDD. Staff observed that “it would be possible for a prospect to open nothing but the separate receipt page.”

Annual and Quarterly Updating. The Amended FTC Rule remains largely consistent with the original FTC Franchise Rule, but with some changes – especially for franchisors accustomed to preparing disclosure using the UFOC format. First, annual updates must be prepared with 120 days of fiscal year end. This, combined with the new approach in Item 21, which eliminates the need for unaudited financial statements (unless there has been a material change, as discussed below), means that most franchisors will prepare their annual updates to the FDD by the end of the 120th day after fiscal year end. Second, Sections 436.7(b) and 436.9(f) require that if there have been material changes to the information in the FDD – other than in Item 19 – a quarterly update is necessary and can be provided in a supplemental form. For financial updates that reflect material changes, these updates can be unaudited under Section 436.7(e). Third, for changes to the Item 19 disclosures, under Section 436.7(d), updates must be provided when there are changes to the information disclosed, or when the

⁵⁴ 16 C.F.R. § 436.6(i) (this requirement applies whether the FDD is provided in paper or electronic form). In FAQ #15, the FTC’s staff also expressed the view that the recordkeeping requirement applied to information concerning the “franchise seller(s)” involved in a specific transaction.

⁵⁵ Under the E-SIGN Act, 15 U.S.C. §§ 101(c)(2)(B) and 101(g), Congress eliminated most statutory and regulatory limitations (in both federal and state law) to electronic verifications and acknowledgements of receipt.

underlying supporting data for the claim. For franchisors that file with the registration states, these changes may provide ephemeral comfort – as some states (e.g., Hawaii) tie renewal of the registration to the 90th day past fiscal year end, and most states that review the FDD typically require amendment upon the occurrence of a material change.⁵⁶

IV. CONCLUSION

Franchise practitioners are still sorting out – as are government lawyers at both the federal and state level – how to best implement and apply the Amended FTC Rule disclosure requirements. Flexibility and thoughtful consideration of the law by all parties concerned is needed to apply the Amended FTC Rule’s requirements in the practical, real-world environment faced by franchisors as well as prospective franchisees. Hopefully, this paper and the discussion that will take place at the Forum will serve a useful role in continuing that dialogue.

⁵⁶ See, e.g., Section 5(4) of the Illinois Franchise Disclosure Act, reprinted at Bus. Franchise Guide (CCH) ¶ 3130.05.

Appendix A

Amended Franchise Rule FAQs With Prefatory Index by Disclosure Item and Subject¹

Item 1: The Franchisor, and any Parents, Predecessors and Affiliates

FAQ 16 - What is the scope of the “parent” disclosures, as set forth in Items 1, 3, 4, and 21 of the amended Rule?

Item 3: Litigation

FAQ 5 -Is the disclosure of whether the franchisor was a party to any material civil action involving the franchise relationship in the last fiscal year. cumulative – that is, does the franchisor have to disclose any suit to which it is a party that was ongoing in the last fiscal year?

FAQ 16 -What is the scope of the “parent” disclosures, as set forth in Items 1, 3, 4, and 21 of the amended Rule?

Item 4: Bankruptcy

FAQ 16 -What is the scope of the “parent” disclosures, as set forth in Items 1, 3, 4, and 21 of the amended Rule?

Item 5: Initial Fees

FAQ 10 - Can a franchisor avoid the seven-day waiting period by disclosing a range of initial fees, with a blank in the agreement that the parties will sign to be filled in later for the exact fee?

Item 6: Other Fees

FAQ 13 - May a franchisor use separate charts for different types of franchise agreements?

Item 7: Estimated Initial Investment

FAQ 13 - May a franchisor use separate charts for different types of franchise agreements?

¹ Prepared by the Division of Marketing Practices in the Bureau of Consumer Protection of the Federal Trade Commission. The views expressed in the FAQs are those of Commission staff responsible for enforcing the Franchise Rule, and do not necessarily reflect the views of the Commission or of any individual Commissioner.

Item 8: Restrictions on Sources of Products and Services

FAQ 18 - Does Item 8 of the amended Rule require the disclosure of a *de minimis* ownership interest in a supplier by an officer of the franchisor, and is there a threshold level of ownership that triggers disclosure?

Item 9: Franchisee's Obligations

FAQ 13 - May a franchisor use separate charts for different types of franchise agreements?

Item 11: Franchisor's Assistance, Advertising, Computer Systems, and Training

FAQ 13 - May a franchisor use separate charts for different types of franchise agreements?

Item 12: Territory

FAQ 10 - With respect to a protected territory – can a franchisor avoid the seven-day waiting period by disclosing a general formula for determining a protected territory in the copy of the standard agreement attached to the disclosure document with a blank to be filled in later for the specific term in the actual franchise agreement that the parties will sign?

FAQ 25 - Item 12 requires that a franchisor that does **not** provide an exclusive territory include a disclaimer underscoring that fact. What constitutes an “exclusive territory” that would permit a franchisor to omit this disclaimer?

Item 17: Renewal, Termination, Transfer and Dispute Resolution

FAQ 13 - May a franchisor use separate charts for different types of franchise agreements?

Item 19: Financial Performance Representations

FAQ 8 - Does the amended Rule now prohibit the use of performance claims based upon affiliates?

Item 20: Outlets and Franchisee Information

FAQ 13 - May a franchisor use separate charts for different types of franchise agreements?

FAQ 19 - Does Item 20 of the amended Rule require franchisors to disclose the names of franchisees that have binding franchise agreements, but have not opened an outlet, and of former franchisees who never opened an outlet?

Item 21: Financial Statements

FAQ 4 - Must a franchisor include in its disclosure document the financials of its parent when the parent only sells goods or services to franchisees?

FAQ 9 - Should “development agents” be treated as subfranchisors because they provide post-sale services to franchisees and, thus, must include financial statements and other information in the disclosure document?

FAQ 11 - Item 21 of the amended Rule permits a new franchisor to issue an unaudited initial balance sheet, so long as that balance sheet is “prepared in accordance with generally accepted accounting principles. What is the CPA’s responsibility to verify the data, and what is the franchisor’s responsibility in terms of the data used to prepare the statement?

FAQ 16 - What is the scope of the “parent” disclosures, as set forth in Items 1, 3, 4, and 21 of the amended Rule?

FAQ 17 - Can financial statements be audited by a Canadian chartered accountant who is unable to state that he or she is an independent certified public accountant? What about other foreign accountants?

Item 23: Receipts

FAQ 15 - How may a franchisor taking advantage of the amended Rule’s disclosure provisions effectively comply with the Item 23 receipt requirement?

FAQ 12 - The amended Rule requires franchisors to disclose on the Item 23 receipt page the “name, principal business address, and telephone number of each franchise seller offering the franchise.” Who is a “franchise seller” for purposes of this disclosure? If at the time of furnishing the disclosure document a franchisor does not know the particular seller, such as a broker, what should Item 23 of the disclosure document say?

FAQ 23 -Must a franchisor identify more than a single individual as a “franchise seller” on its Item 23 receipt, or must a franchisor supplement the receipt page if that is necessary to list every individual with whom a prospective franchisee has significant contacts before the sale is concluded? If any supplementation is required, would it trigger a new 14 calendar day waiting period before a sale may be completed, or may the supplementation be accomplished at the closing of a sale by requiring a purchaser to list all the individual franchise sellers with whom she has had significant contacts?

Updating Disclosures

FAQ 14 - The amended Rule prohibits a franchisor from failing, “upon reasonable request,” to furnish a copy of its disclosure document to a prospective franchisee early in the sales process. What happens if a prospective franchisee asks for a copy of the disclosure document at a time when the franchisor is in the process of preparing its annual update or is awaiting registration in one or more of the registration states? Should the franchisor furnish a document that it knows will soon be updated with more current information?

FAQ 24 - Does a franchisor risk violating section 436.9(e) of the Rule if a prospective franchisee makes a reasonable request for the franchisor's Franchise Disclosure Document ("FDD") earlier in the sales process than required by section 436.2, but at a time when an applicable state franchise investment law prohibits the franchisor from providing its FDD to that prospect until an amendment reflecting a material change has been filed with or made effective by the state?

Seven-Day Waiting Period

FAQ 10 - With respect to a protected territory – can a franchisor avoid the seven-day waiting period by disclosing a general formula for determining a protected territory in the copy of the standard agreement attached to the disclosure document with a blank to be filled in later for the specific term in the actual franchise agreement that the parties will sign?

Franchise Sellers

FAQ 7 - At times, a franchisor may pay existing franchisees a fee for referring leads to the franchisor. In such circumstances, are the existing franchisees acting as "franchise sellers" under the amended Rule? If so, are such existing franchisees subject to the amended Rule's prohibitions section?

FAQ 20 - When a franchise broker seeks to induce franchise purchases by independently offering a rebate or similar payment from its own funds, must a franchisor disclose that fact? May such a rebate offer be limited in its duration?

Phase-In Issues

FAQ 22 - If a prospective franchisee has received a UFOC disclosure document prior to July 1, 2008, but has not purchased a franchise by that date, must the franchisor provide the prospective franchisee with its Franchise Disclosure Document ("FDD") 14 calendar days before he or she pays any money or signs a binding agreement in connection with the proposed franchise sale?

FAQ 6 - If a franchisor wishes to use the amended Rule on or after July 1, 2007, must it first amend its current UFOC or FTC disclosure document?

FAQ 1 - On July 1, 2007, franchisors may start to use the amended Franchise Rule. Does this mean that franchisors can use the amended Rule disclosure format only as of July 1, 2007, or does it mean that franchisors may also apply the non-disclosure provisions (such as timing provisions and prohibitions) of the amended Rule as well? For example, may a franchisor ignore the "first personal meeting" requirement after July 1, 2007, if the franchisor continues to use the UFOC Guidelines format?

FAQ 2) - On July 1, 2007, may franchisors furnish disclosures electronically even if they elect to use the original Rule or UFOC format?

Exemptions

FAQ 3 - Does the new large investment exemption apply to entities?

Amended Franchise Rule FAQs

(reprinted from <http://www.ftc.gov/bcp/franchise/amended-rule-faqs.shtml#23>)

1. **On July 1, 2007, franchisors may start to use the amended Franchise Rule. Does this mean that franchisors can use the amended Rule disclosure format only as of July 1, 2007, or does it mean that franchisors may also apply the non-disclosure provisions (such as timing provisions and prohibitions) of the amended Rule as well? For example, may a franchisor ignore the “first personal meeting” requirement after July 1, 2007, if the franchisor continues to use the UFOC Guidelines format?**

Answer: Since original promulgation of the Franchise Rule, the Commission has always permitted franchisors to comply either by following the provisions of the Franchise Rule itself, or by following the UFOC Guidelines. However, “mix-and-match” disclosures are not permitted: franchisors must use all of one set of requirements or all of the other set. They may not combine elements of the two different formats in a single disclosure document. This same policy will continue in effect on and after July 1, 2007. Franchisors will still have to select one set of disclosure requirements to follow, but they will have three options instead of just two. They can choose to follow either the original Rule, the UFOC Guidelines, or the amended Rule. Once they make a choice, they must be consistent, following the chosen set of requirements and none other until July 1, 2008, at which time the only format permitted will be the one prescribed in the amended Rule.

This means that a franchisor that chooses to comply with the original Rule on July 1, 2007, must continue complying with the “first personal meeting” provision, as well as other provisions unique to the original Rule – such as the five business-day contract review provision and separate earnings claims statement – until July 1, 2008.

Similarly, a franchisor that chooses to use the UFOC format on July 1, 2007, would not have to comply with any of the amended Rule’s provisions – for example, the amended Rule’s integration clause prohibition – until July 1, 2008.

2. **On July 1, 2007, may franchisors furnish disclosures electronically even if they elect to use the original Rule or UFOC format?**

Answer: From July 1, 2007, until June 30, 2008, franchisors must select one and only one set of disclosure requirements: original Franchise Rule, amended Franchise Rule, or UFOC Guidelines. Technically, that would preclude a franchisor from furnishing disclosures electronically unless the franchisor opted to use the amended Rule – the only one of the three available sets of disclosure requirements that expressly permits electronic disclosure. Nevertheless, there are strong policy reasons for permitting franchisors to take advantage of technologies that offer the promise of reduced compliance costs, and the FTC staff would not recommend enforcement action against a franchisor that disclosed electronically and was otherwise in total compliance with either the UFOC Guidelines or the original Franchise Rule. This approach ensures that franchise purchasers receive adequate protection and at the same time conforms to the spirit of the Electronic Signatures in Global and National Commerce Act (“E-SIGN”), 15 U.S.C. 7001. Moreover, electronic disclosure is a method of delivery; it does not affect substantive disclosure requirements. Accordingly, for FTC purposes, all franchisors can

begin using electronic disclosure on July 1, 2007. Of course, any franchisor electing to furnish disclosures electronically must follow the provisions for doing so set forth in the amended Rule.

3. Does the new large investment exemption apply to entities?

Answer: The large investment exemption focuses on individuals and level of their investment, based on the rationale that a prospective investor able to invest at least \$1 million (minus franchisor financing and the cost of unimproved land) is likely to be sophisticated and able to make an investment decision without federal government intervention. As noted in the Statement of Basis and Purpose, that rationale does not pertain when individuals, each investing only a small amount, combine in a group. Merely aggregating the small investments of a group of individuals does not transform the individuals into sophisticated investors. For that reason, the amended Rule requires that at least one individual in an investor group contribute at the \$1 million threshold. The same analysis applies in the case of individual owners of an entity. In order to ensure that such owners are sophisticated, at least one individual owner must contribute at the \$1 million threshold.

The large investment exception, however, does not address how a qualifying individual may organize its business. Nothing in the amended Rule would preclude a qualifying individual contributing \$1 million – and thus exempt from the amended Rule – from forming a partnership, corporation, or joining with a corporation or other entity, to operate the franchised outlet after signing the franchise agreement.

4. Must a franchisor include in its disclosure document the financials of its parent when the parent only sells goods or services to franchisees?

Answer: The amended Rule requires separate financials for any “parent that commits to perform post-sale obligations for the franchisor or guarantees the franchisor’s obligations.” Thus, this requirement would apply when the franchisor has an obligation to provide goods or services to franchisees, and that obligation is guaranteed or assumed by the franchisor’s parent. If a parent happens to supply goods or services to franchisees where there is no underlying obligation on the part of the franchisor to supply them, then the parent is no different from any other third-party supplier and its financials need not be disclosed. On the other hand, if a franchisor is obligated to provide goods and services and the parent assumes that responsibility, or the franchisor arranges for the parent to provide goods and services directly to franchisees on its behalf, then the parent’s financials must be disclosed.

5. Item 3 of the amended Rule states that a franchisor must state whether it was “a party to any material civil action involving the franchise relationship in the last fiscal year.” At the same time, the Statement of Basis and Purpose for the amended Rule says that this disclosure of franchisor-initiated litigation covers only suits filed in the last fiscal year and needs to be updated only annually. Is the disclosure cumulative – that is, does the franchisor have to disclose any suit to which it is a party that was ongoing in the last fiscal year?

Answer: The franchisor-initiated litigation disclosure is intended to capture suits that were **filed** by the franchisor in the last fiscal year. In that regard, “party to a material civil action in the last fiscal year” means “party to **any new** material civil action filed in the last fiscal year.” This disclosure, therefore, is not cumulative: pending suits **filed** by the franchisor against a franchisee more than a fiscal year ago need not be included.

Accordingly, when preparing an annual update, the franchisor must disclose the suits it has filed against franchisees in the last fiscal year only (*e.g.*, 2006 suits). Those suits must remain in the disclosure document used for the new fiscal year (*e.g.* 2007 disclosure document). No quarterly updating is required. Franchisors that initiate suits in the middle of a fiscal year or companies new to franchising can wait until their next annual update (*e.g.*, 2008) to reference these new suits. At the beginning of each new fiscal year (*e.g.*, 2008), the franchisor should delete the list of previously disclosed suits (*e.g.*, 2006 suits) and substitute it with any new franchisor-initiated litigation filed in the most recently concluded fiscal year (*e.g.*, 2007 suits).

6. If a franchisor wishes to use the amended Rule on or after July 1, 2007, must it first amend its current UFOC or FTC disclosure document?

Answer: On or after July 1, 2007, franchisors may start using the amended Franchise Rule. By July 1, 2008, all franchisors must use the amended Rule format only. It is entirely at the discretion of each individual franchise system to decide when during the course of the phase-in period to make the conversion to the amended Rule format.

Most likely, many franchisors will start using the amended Rule when they prepare their annual update. For example, we expect that many franchisors with a calendar-year fiscal year will start using the amended Rule in March or April of 2008, when preparing their annual update for 2008.

Under the amended Rule, a franchisor need not amend its disclosure document immediately in order to start using the amended Rule. For example, a franchisor with a calendar-year fiscal year may decide on July 1, 2007, that it will start using the amended Rule format on September 1, 2007, which falls within the third quarter of the franchisor's fiscal year. The amended Rule requires franchisors to revise their disclosure document only quarterly. Accordingly, the franchisor need not revise its current disclosure document until the time for preparing a quarterly update, which, in the example, would fall in October, 2007.

Nonetheless, if the franchisor continues to sell franchises, it must furnish a quarterly update for the third quarter that contains all of the required disclosures set forth in the amended Rule. For example, the quarterly update must include the amended Rule's more detailed Item 20 information. For that reason, franchisors, as a practical matter, may wish to amend their disclosure documents when they start using the amended Rule – even if they do so during a fiscal quarter – rather than preparing detailed quarterly updates until their next annual update.

Regardless of when it starts to update its disclosures, the franchisor in the example above must begin to comply with the amended Rule's timing provisions and prohibitions on September 1, 2007. For example, even if the franchisor decides to update its disclosures through a quarterly update, it must immediately start on September 1, 2007,

complying with the amended Rule's non-disclosure provisions, such as timing provisions (e.g., disclosure earlier in the sales process upon reasonable request) and prohibitions (e.g., prohibition against inclusion of disclaimers or waivers).

- 7. At times, a franchisor may pay existing franchisees a fee for referring leads to the franchisor. In such circumstances, are the existing franchisees acting as “franchise sellers“ under the amended Rule? If so, are such existing franchisees subject to the amended Rule’s prohibitions section?**

Answer: Merely accepting compensation for referring leads to a franchisor, without more, is not enough to bring an existing franchisee within the amended Rule's definition of “franchise seller“ and, therefore, does not subject the franchisee to the amended Rule's prohibitions.

This issue arises under the amended Rule's definition of “franchise seller,” which includes brokers. The Statement of Basis and Purpose to the amended Rule states that a “broker“ is a person who: “(1) is under contract with the franchisor relating to the sale of franchises; (2) receives compensation from the franchisor related to the sale of franchises; and (3) arranges franchise sales by assisting prospective franchisees in the sales process.” At the same time, the Statement of Basis and Purpose states that the term “broker” is sufficiently narrow to exclude existing franchisees who may refer potential franchisees to the franchisor because such individuals are not “under contract with the franchisor to sell franchises.” 72 Fed. Reg. 15,462 n. 169 (Mar. 30, 2007).

- 8. Item 19 of the amended Rule deletes the UFOC’s express permission to use performance results of substantially similar businesses of affiliates. Was this intentional? Does the amended Rule now prohibit the use of performance claims based upon affiliates?**

Answer: All financial performance representations must have a “reasonable basis.” When a franchisor has adequate performance data of its own upon which to base a performance representation, basing a financial performance representation on affiliate information likely would not be “reasonable.” Nevertheless, in limited circumstances, a franchisor may base a financial performance claim upon the results of operations of the substantially similar business of an affiliate.

The question posed above refers to the following statement in the UFOC Guidelines' instructions for Item 19:

“In the absence of an adequate operating experience of its own, a franchisor may base an earnings claim upon the results of operations of a substantially similar business of a person affiliated with the franchisor or franchisees of that person; provided that disclosure is made of any material differences in the economic or market conditions known to, or reasonably ascertainable by, the franchisor.”

The amended Rule does not incorporate this specific language; nevertheless, consistent with the UFOC Guidelines, the amended Rule does allow franchisors to use affiliate information as a basis for a performance claim in certain narrow circumstances –

specifically, when the franchisor lacks an adequate operating experience of its own. However, as in the case of using any financial performance representation based on a subset of outlets that share a particular set of characteristics, the franchisor must also disclose any characteristics of such outlets that may differ materially from the outlets being offered for sale.

9. Should “development agents” be treated as subfranchisors because they provide post-sale services to franchisees and, thus, must include financial statements and other information in the disclosure document?

Answer: No. Even if a person performs post-sale on behalf of a franchisor, that person or entity is not a “subfranchisor” under the amended Rule **unless** that person is a party to the franchise agreement (or to another agreement involved in the franchise). This is true regardless of the name given to the person, be it “development agent,” “area developer,” or “regional developer.”

Staff’s determination as to whether a “development agent” should be considered a “subfranchisor” begins with consideration of how the amended Rule treats the term “subfranchisor.” The amended Rule delineates the term “subfranchisor” within the definition of the term “franchisor,” as follows:

Franchisor means any person who grants a franchise and participates in the franchise relationship. Unless otherwise stated, it includes subfranchisors. For purposes of this definition, a “subfranchisor” means a person who functions as a franchisor by engaging in both pre-sale activities and post-sale performance.

Thus, a “subfranchisor” is a person “who functions as a franchisor;” by use of the qualifying phrases “grants a franchise” and “participates in the franchise relationship,” the amended Rule clarifies that in order to be considered a subfranchisor, a party must have – as a franchisor has – (1) the authority to enter into a franchise agreement (or another agreement relating to the franchise), and (2) as a result of entering into such an agreement, that party is obligated to perform after the purchase of the franchise is consummated.

The role of a subfranchisor is materially different from that of a broker, for example, because a broker typically is not a party to the franchise agreement and does not have post-sale contractual obligations to franchisees. In this regard, the amended Rule’s Statement of Basis and Purpose, in the discussion of Item 21 regarding subfranchisor financial information, states that “the term ‘subfranchisor’ is limited in the Rule to circumstances where the subfranchisor steps into the shoes of the franchisor by selling [franchises] and performing post-sale obligations. It does not reach those individuals who may be called ‘subfranchisors,’ but who act like brokers, having no post-sale commitments to franchisees.” 72 Fed. Reg. 15,511 (Mar. 30, 2007).

10. What constitutes a “fill-in-the-blank” provision for purposes of the requirement [§ 436.2(b)] that when a franchisor makes unilateral and material changes in the terms and conditions of an agreement, a prospective franchisee must receive the

revised agreement at least seven calendar days signing? The Statement of Basis and Purpose indicates that material changes in the terms and conditions of do not include instances where “the only differences between the standard agreements and the completed agreements are ‘fill-in-the-blank’ provisions, such as the date, name, and address of the franchisee.” But might there be other “fill-in-the-blank” provisions that would not necessarily trigger the seven-day waiting period?

Specifically – with respect to a protected territory – can a franchisor avoid the seven-day waiting period by disclosing a general formula for determining a protected territory in the copy of the standard agreement attached to the disclosure document with a blank to be filled in later for the specific term in the actual franchise agreement that the parties will sign?

Similarly, could a franchisor avoid the seven-day waiting period by disclosing a range of initial fees, with a blank in the agreement that the parties will sign to be filled in later for the exact fee?

Answer: In the Statement of Basis and Purpose, the Commission made clear that it will interpret “fill-in-the-blank” provisions narrowly. “To the extent that substantive contractual details – such as geographic area of a protected territory and interest rates – are not disclosed in the basic disclosure document or its attachments, then the completed document must be disclosed seven calendar days before signing.” 72 Fed. Reg. 15471 n.277 (Mar. 30, 2007). The seven-day waiting period ensures that, before entering into any franchise agreement or paying any related fee, a prospective franchisee can review and understand all material terms and conditions of the franchise arrangement. Accordingly, where the franchisor includes in the franchise agreement material terms that previously have not been disclosed or unilaterally changes material terms that previously have been disclosed, then the amended Rule requires that the prospective franchisee have at least seven calendar days to review the proposed revised agreement. This does not extend to non-substantive, fill-in-the-blank provisions.

Substantive terms of a franchise arrangement – such as fees, interest rate, and the parameters of a protected territory – must be disclosed in the agreement attached to the basic disclosure document or the franchisor must afford the prospect seven days to review the terms before signing or paying a fee. Of course, if the parties are negotiating such terms at the initiation of the prospect, then no additional waiting period is required.

On the other hand, with respect to protected territories, a franchisor may fill in a term in a franchise agreement without triggering the seven-day review period, provided the territory previously has been identified, but the exact name or circumstance was unknown at the time of disclosure. For example, if it is a franchisor’s practice to grant protected territories on a county-wide basis, the franchisor may include a statement in its disclosure document to the effect that: “We assign protected territories by county. Your protected territory will be [name of county], in [state].” This sufficiently details the scope of the protected territory – an entire county – to enable the prospect to apply the statement to his or her specific proposed outlet without any further explanation. In the opinion of FTC staff, filling in the exact name of the county at a later date would not necessarily constitute a substantive change. Nevertheless, a vague description of a protected territory – such as a statement that the protected territory will range from 1 to 10 miles from the prospective franchisee’s outlet – is insufficiently detailed to give a prospective franchisee notice of the likely scope of his or her territory; filling in the exact

number of miles at a later date, therefore, would be a substantive modification of the franchise agreement triggering the seven-day waiting period.

11. **Item 21 of the amended Rule permits a new franchisor to issue an unaudited initial balance sheet, so long as that balance sheet is “prepared in accordance with generally accepted accounting principles.” What does that mean? In other words, what is the CPA’s responsibility to verify the data, and what is the franchisor’s responsibility in terms of the data used to prepare the statement?**

Answer: While Item 21 permits start-up franchisors that do not already have audited financial statements to phase-in audited financial statements, it nonetheless states that franchisors must prepare audited financial statements as soon as practicable, and it instructs that an unaudited statement must be prepared “in a format that conforms as closely as possible to audited statements.” In the Statement of Basis and Purpose for the amended Rule, the Commission stated that an audit is not required for start-up franchisors, but financial statements nonetheless must conform to generally accepted accounting principles (“GAAP”). There is no requirement in the amended Rule that the opening balance sheet be prepared by an accountant, and it may well be the case that many start-up franchisors will not employ an accountant to prepare such balance sheets. While franchisors have flexibility in preparing such statements, in the opinion of FTC staff, a franchisor’s management would be expected to look to GAAP for guidance. For example, staff would expect an opening balance sheet to be in the format of a typical balance sheet prepared under GAAP and to include explanatory notes, where warranted, to ensure that the balance sheet is clear and accurate. In short, balance sheets must be in a format that conforms as closely as possible to audited statements prepared under GAAP. Further, to avoid any confusion with an audited balance sheet, the franchisor must clearly and conspicuously note that the balance sheet is unaudited.

12. **The amended Rule requires franchisors to disclose on the Item 23 receipt page the “name, principal business address, and telephone number of each franchise seller offering the franchise.” Who is a “franchise seller” for purposes of this disclosure? If at the time of furnishing the disclosure document a franchisor does not know the particular seller, such as a broker, what should Item 23 of the disclosure document say?**

Answer: A “franchise seller,” under the amended Rule is “a person that offers for sale, sells, or arranges for the sale of a franchise. It includes the franchisor and the franchisor’s employees, representatives, agents, subfranchisors, and third-party brokers who are involved in franchise sales activities.” As stated in the Statement of Basis and Purpose for the amended Rule, this disclosure provides prospective franchisees with contact information for any seller with whom they are dealing and is “also helpful for law enforcement purposes, identifying who may be responsible for furnishing the disclosures.”²

When preparing the receipt page, franchisors should identify and include contact information for those particular sellers “offering the franchise.” That means those

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72 Fed. Reg. 15445, 15513 (Mar. 30, 2007)

persons who have significant contacts with the prospective franchisee – for example, individuals assisting specific prospective franchisees in completing the application and other forms, or engaging in ongoing conversations with the specific prospective franchisees throughout the sales process. FTC staff believes, in particular, that any person who receives a sales commission and/or quota credit if the deal is consummated is the type of “franchise seller” who must be listed on the receipt.

The Statement of Basis and Purpose makes clear that this disclosure requirement is not intended to replicate Item 2 of the current UFOC Guidelines – that is, franchisors should not include a generalized list of all subfranchisors, brokers, or other individuals that may be involved in the sales process, but who do not have contacts with the individual prospective franchisee who will sign the receipt page.³ Nevertheless, FTC staff recognizes that the identity of a franchise seller may not be known at the time the franchisor furnishes the disclosure document. This is particularly true if, under the amended Rule, the prospective franchisee takes advantage of the right to obtain a copy of the disclosure document early in the sales process.

A franchisor need not create an individualized disclosure document for each franchise sale. It is the FTC staff’s view that if, at the time of furnishing the disclosure document, a franchisor does not know the particular seller, such as a broker, the franchisor has several options. First, a franchisor could include an instruction in the receipt page that the prospective franchisee write in the name of the franchise seller before signing and returning the receipt page to the franchisor. Second, the franchisor could: (1) attach to the previously signed receipt a statement, business card, or other document showing the name of the seller; and (2) send a copy of the attachment to the prospective franchisee so that the prospective franchisee has a copy of the completed receipt. At that point, both the franchisor and prospective franchisee will each have a copy of the same receipt. In short, in the FTC staff’s view, the absence of an identifiable seller at the time of disclosure should not force a delay in the prospective franchisee’s ability to sign the receipt page, provided that the receipt page is updated once the identity of the seller is known.

Finally, FTC staff notes that the amended Rule’s instructions require franchisors to retain for each completed franchise sale “a copy of the signed receipt for at least three years.” Staff expects that copies of signed receipts will include the required contact information for sellers, either because such contact information was filled in before the franchisor furnishes disclosures or was attached to the receipt once such contact information was known after the prospective franchisee signed the receipt.

13. May a franchisor use separate charts in Item 17 for different types of franchise agreements?

Answer: Yes. A franchisor always can use separate charts for different agreements (e.g., subfranchisor agreements), whether those be in Item 17, Item 20, or other disclosure items.

³ *Id.*

As noted in the Statement of Basis and Purpose, the amended Rule should be applied in a manner that is consistent with historic practices. For instance, with respect to this particular issue, the NASAA commentary on Item 20 specifically states that franchisors should use separate charts for statistics reflecting a subfranchisor's region and for statistics reflecting national data for the franchise being offered. The use of separate charts for different agreements fosters precision and clarity, consistent with the goal of full and accurate disclosure.

- 14. The amended Rule prohibits a franchisor from failing, “upon reasonable request,” to furnish a copy of its disclosure document to a prospective franchisee early in the sales process. What happens if a prospective franchisee asks for a copy of the disclosure document at a time when the franchisor is in the process of preparing its annual update or is awaiting registration in one or more of the registration states? Should the franchisor furnish a document that it knows will soon be updated with more current information?**

Answer: If a request for disclosures comes at a point in time when a franchisor is not obliged by section 436.7 to have just finished updating its disclosures, the franchisor may provide the then-current version of the disclosures, even if the disclosures will change with the next required update. For example, if the franchisor is in the middle of its fiscal quarter or is in the middle of the 120-day period after the close of its fiscal year for preparing an annual update, it may continue to provide prospects with its most current document. In order to avoid any possible misrepresentations, however, the “best practice” would be for the franchisor to inform the prospect that it is preparing revised disclosures and to make such revised disclosures available to the prospective franchisee when issued or registered. At the very least, however, the franchisor must provide copies of its updates to a prospect, upon reasonable request, before the prospect signs the franchise agreement.

The amended Rule, like the original Rule, provides specific times when a franchisor must furnish its disclosure documents. It also specifies when a franchisor must update its disclosures. But the amended Rule does not require a franchisor to update its disclosures continuously or immediately upon every new occurrence, or to stop selling until it has updated its disclosures. Accordingly, the franchisor may give out its then-current disclosure document pursuant to either the amended Rule's 14 calendar-day disclosure requirement [§ 436.2(a)], or the amended Rule's requirement to provide the disclosure document “earlier in the sales process than required under § 436.2 of this part, upon reasonable request.” Nevertheless, in the latter instance, prospects who request and receive the disclosure document early in the sales process may not, when they are about to sign the franchise agreement, have the benefit of the most current information. Therefore, the Commission included § 436.9(f) in the amended Rule, which forbids a franchisor from failing to furnish a copy of its most recent disclosure document and any quarterly updates to a prospective franchisee, upon reasonable request, before the prospective franchisee signs a franchise agreement.

- 15. How may a franchisor taking advantage of the amended Rule's disclosure provisions effectively comply with the Item 23 receipt requirement?**

Answer: The amended Rule permits franchisors flexibility in complying with the Item 23

receipt requirement. Below is the staff of the Commission's view on three possible alternatives posed by practitioners.

A. Use of link to external receipt webpage

Section 436.6(d) of the amended Franchise Rule prohibits franchisors from including in any electronic disclosure document external links to materials outside of the disclosure document itself. The first requester proposes an exception to this prohibition for the limited purpose of facilitating compliance with the amended Rule's Item 23 receipt requirement. Specifically, he proposes that franchisors be permitted to place an icon (such as a "submit" or "submit receipt" button) on the Item 23 receipt page that links it to an external receipt webpage where the prospective franchisee could acknowledge receipt of the document. According to this proposal:

The external receipt webpage would be accessible only from a link in either of the two receipt pages that are included within the electronic disclosure document;

The external receipt webpage would include only an online form to be completed for the purpose of acknowledging receipt of the disclosure document. The content of the online form would be identical to that required under Item 23 of the amended Rule, adapted only to accommodate the online process (such as including instructions necessary for completing and submitting the form); and

The external receipt webpage would contain no additional content or secondary links.

For the following reasons, FTC staff believes the proposed limited use of an external link to a web-based receipt page, as described above, is permitted under the amended Rule, because it is consistent with the goal of permitting electronic disclosure and does not diminish the level of protection the amended Rule provides to prospective franchisees.

As noted above, the amended Rule prohibits the use of external links. This prohibition is necessary to preserve the integrity of a disclosure document. Without this prohibition, nothing would prevent a franchisor from including external links to materials that are either false or deceptive, that contradict the franchisor's authorized disclosures, or that are not required or permitted by either federal or state franchise disclosure laws. Nevertheless, § 436.6(d) of the amended rule does allow inclusion of scroll bars, internal links, and search features "for the sole purpose of enhancing the prospective franchisee's ability to maneuver through an electronic version of a disclosure document."

As proposed in the requester's letter, the external link to a webpage accessible only to recipients of a disclosure document would facilitate compliance with the Item 23 receipt requirement. The proposed webpage would be identical to the Item 23 receipt page, with the addition of instructions for submitting the receipt. This is consistent with amended Rule Item 23, which permits franchisors to include instructions for submitting the receipt in the receipt page itself. Finally, this proposal ensures that no other links or materials will be accessible from the webpage, thereby preventing access to materials that may be deceptive or false, contradictory, or not required or permitted in a disclosure document by federal or state law. Accordingly, in the opinion of FTC staff, it would not violate the amended Rule for a franchisor to include a link in the receipt page to a

webpage that facilitates submission of the Item 23 receipt provided that: (1) the web-based receipt page is accessible only by prospective franchisees from Item 23 of an electronic disclosure document; and (2) no other content or external links are included in the web-based receipt other than information required or permitted by Item 23 of the amended Rule (*i.e.*, instructions for submitting the receipt).

B. Icon enabling prospective franchisees to print receipt page

A second requester suggests that franchisors be permitted to include an icon on the electronic receipt page, that, when pressed, would enable the prospect to print out a copy of just the receipt, which could then be signed and mailed or faxed to the franchisor. This would facilitate compliance with the Item 23 receipt requirement by enabling prospects to print out the receipt without printing out the entire disclosure document. In the opinion of FTC staff, this is an acceptable method of ensuring compliance with the amended Rule's receipt page requirement.

C. Separate receipt page attachment

Finally, a third requester suggests that franchisors be permitted to email a prospect two documents: (1) the basic disclosure document; and (2) a separate receipt page that could be printed out, signed, and returned to the franchisor. In FTC staff's opinion, this would not be an acceptable method of complying with the Item 23 receipt page requirement because it would be possible for a prospect to open nothing but the separate receipt page. In such an instance, there would be no proof that the prospect, in fact, was able to open and had the opportunity to review the disclosure document itself. The scenario proposed by the third requester could easily be modified, however, using one of the two methods posited by the other two requesters that are discussed above – inserting a link to a separate web-based receipt page in the text of the Item 23 receipt itself, or including an icon in the Item 23 receipt that enables a prospect to print out just the receipt page. Either of these two approaches would ensure that each prospect submitting a receipt had, in fact, opened the electronic disclosure document.

16. What is the scope of the “parent” disclosures, as set forth in Items 1, 3, 4, and 21 of the amended Rule?

Answer: The scope of the “parent” disclosures in the amended Rule varies depending upon the specific disclosure items. Below, FTC staff addresses specific questions that have been raised regarding the parent disclosures found in Items 1, 3, 4, and 21 of the amended Rule. As an initial matter, the original Franchise Rule, unlike the Uniform Franchise Offering Circular (“UFOC”) Guidelines, always has required the disclosure of parent information, even though the states do not require the disclosure of such information. Accordingly, in large measure, the amended Franchise Rule retains these provisions from the original Rule, with some modifications, as discussed below.

Before addressing the specific parent disclosures set forth in the amended Rule, FTC staff notes the definition of “parent” set out at section 436.1(m): “an entity that controls another entity directly, or indirectly through one or more subsidiaries.” The definition focuses on “control,” not mere ownership. Accordingly, a parent that merely owns, but does not control, a franchise system – for example, the parent does not shape the

franchisor's policies or control franchise sales or operations – is not a “parent” for purposes of any disclosure item.

A. Item 1: Identity of any parents

One question is whether the term “parent” in Item 1 is intended to be interpreted narrowly to cover only the “ultimate parent that controls all the subsidiaries.” Item 1 requires franchisors to disclose “[t]he name and principal business address of any parents.” The use of the word “parents” is intentional, anticipating that a franchisor may be required to disclose one or more parents, provided that such parents control the franchisor. This issue is addressed in the SBP.¹ There, the Commission made clear that a franchisor must disclose all parents, including intermediate parents, specifically rejecting the suggestion that only the ultimate parent be disclosed.²

This does not mean that a franchisor must disclose all parent-entities in the chain of ownership of the franchisor. Rather, the franchisor must disclose only those parents that in fact exercise control over the policies and direction of the franchise system, consistent with the definition of parent, as mentioned above. As the Commission noted in the Statement of Basis and Purpose (“SBP”), the disclosure of parents – meaning those entities that control the franchise system – is necessary to “ensure that a prospective franchisee understands who may control or influence the franchisor’s operations.”³ For many franchise systems, this may mean the “ultimate parent,” but such determinations can be made only on a case-by-case basis depending upon the particular facts.

B. Item 3: Litigation

Another question asks about the scope of the obligation to disclose parent litigation. Preliminarily, FTC staff notes that Item 3 specifies that litigation of a parent is required only if the parent “induces franchise sales by promising to back the franchisor financially or otherwise guarantees the franchisor’s performance.” Specifically asked is what difference, if any, exists between “financial backing,” on the one hand, and “guaranteeing performance,” on the other.

“Financial backing” here is intended to refer to promises that a parent may make to ensure that the franchise system is and remains on stable financial footing. Typically, this would mean that the parent promises to infuse the franchisor with cash or other assets or to extend credit, if needed, or to pay debts to third parties on behalf of the franchisor. In such a case, the franchisor or its parent induces franchise sales by representing that the purchase of a franchise is a safe investment because the parent will directly or indirectly pay third-party debts – thereby keeping the franchise system financially stable – if the franchisor cannot make such payments itself.

¹ 72 Fed. Reg. 15445, 15475 (Mar. 30, 2007).

² *Id.* n.317. Only the identity of the parent(s) need be disclosed in Item 1. As discussed in the SBP, “[i]n contrast with the Item 1 disclosures for affiliates and predecessors, a franchisor need not disclose, for example, the parent’s business background, length of time selling franchises or engaging in other lines of business.”

³ *Id.*

On the other hand, “guaranteeing performance” refers to promises made between the franchisor’s parent and the franchisor for the benefit of franchisees or from the franchisor’s parent directly to franchisees. Typically, this means that the parent promises to perform obligations to franchisees that the franchisor has undertaken in its franchise agreement, if the franchisor is unable to do so. In such a case, the parent induces franchise sales by promising to fulfill the franchisor’s obligations to franchisees, if the franchisor cannot perform such obligations itself.

C. Item 4: Bankruptcy

Another question asks whether the use of singular term “parent” in the Item 4 bankruptcy disclosures is meant to be distinct from the plural term “parents” in Item 1. Specifically asked is whether, for Item 4 purposes, it is sufficient to disclose only the ultimate parent’s prior bankruptcy, or must intermediate parents be disclosed as well. The disclosure of parent information in Item 4 is intended to be consistent with that of Item 1. If any of the parents listed in Item 1 have had a bankruptcy in the relevant time period, then that information must be disclosed in Item 4. Indeed, in the SBP, the Commission specifically rejected comments suggesting that parent bankruptcy disclosures are unwarranted, finding that parent information is material. The Commission noted, for example, that when a parent is in bankruptcy its assets include any franchisor-subsiary. “Under such circumstances, a prospective franchisee should be made aware that the franchisor in which it is considering investing might be sold, possibly to a competitor or to a company lacking prior franchise experience.”⁴

D. Item 21: Financial statements

Item 21 requires the disclosure of parent financials if the parent “commits to perform post-sale obligations for the franchisor or guarantees the franchisor’s obligations.” A question posed is whether the phrase “post-sale obligations for the franchisor” is intended to capture only those obligations that benefit franchisees, noting that a parent may agree to perform “back office services for the franchisor’s own internal purposes.”⁵ In the opinion of FTC staff, the disclosure of parent financial information is required only when the franchisor’s parent commits to perform post-sale obligations for the direct benefit of franchisees. Agreements between a franchisor and its parent for administrative and other services for the franchisor’s internal purposes do not trigger the parent financial disclosure requirement.⁶

⁴ 72 Fed. Reg. at 15484.

⁵ An additional question is whether Item 21 requires the disclosure of an affiliate’s financials, if the affiliate commits to perform post-sale obligations for the franchisor. The amended Rule makes clear that the disclosure of an affiliate’s financials is voluntary, if the affiliate “absolutely and unconditionally guarantees to assume the duties and obligations of the franchisor under the franchise agreement.” 16 C.F.R. § 436.5(u)(1)(iii). Accordingly, an affiliate need not disclose financials unless it qualifies as a “parent” and commits to perform or guarantees the franchisor’s post-sale obligations.

⁶ A related question is whether the parent financials disclosure would be triggered if a parent’s employees perform services on behalf of a franchisor. Arguably, such services are akin to providing back office support for the franchisor. In other words, is the Item 21 parent financials disclosure obligation limited to where the parent commits to perform obligations directly for the benefit of franchisees under the name of the parent company – meaning that franchisees are specifically looking to the parent company to provide those services (and not simply because an employee of the parent working for the franchisor provides some service for the franchisee)? In the opinion of FTC

Another question is whether the requirement that a parent disclose its financials is triggered by *any* commitment to perform on behalf of the franchisor or whether the requirement is triggered only if the parent commits to perform something more, such as committing to perform substantial post-sale obligations or a preponderance of the post-sale obligations that have to be provided to the franchisee.

As noted above, the amended Rule requires parent financial statements where the parent commits to perform or guarantees the franchisor's obligations. FTC staff believes that the use of the plural "obligations" was intended to convey that the performance of a single or isolated obligation alone is insufficient to trigger the parent financials disclosure. At the same time, Item 21 sets forth no specific threshold standard, such as "substantial obligations," or "preponderance of obligations." Accordingly, FTC staff would expect a parent to disclose its financials if it commits or guarantees to perform more than an isolated obligation to franchisees on behalf of the franchisor.

17. Can financial statements be audited by a Canadian chartered accountant who is unable to state that he or she is an independent certified public accountant? What about other foreign accountants?

Answer: In the view of FTC staff, a Canadian or other foreign accountant or accounting firm may audit financial statements for Franchise Rule purposes if the accountant or accounting firm: (1) is registered with the Public Company Accounting Oversight Board ("PCAOB"); and (2) recently audited one or more financial statements that have been filed with and accepted by the SEC.

Discussion: The question arises from Section 436.5(u) of the amended Franchise Rule (Item 21), which provides that each disclosure document required under the Rule must contain financial statements prepared "according to United States generally accepted accounting principles (GAAP), as revised by any future United States government mandated accounting principles, or as permitted by the Securities and Exchange Commission (SEC)." Further, these financial statements (with a limited exception for those start-up franchisors phasing-in financial statements) "must be audited by an independent certified public accountant (CPA) using generally accepted United States auditing standards (GAAS)."¹

FTC staff do not interpret use of the term "CPA" in the Franchise Rule as permitting only an American CPA to audit financial statements. In staff's view, the Franchise Rule uses the term "CPA" because typically in the offer of franchises in the United States it is a CPA that audits financial statements. The additional language regarding "generally accepted accounting principles (GAAP), as revised by any future United States government mandated accounting principles, or as permitted by the Securities and Exchange Commission (SEC)," argues for a more expansive interpretation than one that

staff, the Item 21 parent financials disclosure is intended to cover formal arrangements between the parent and franchisor for the benefit of franchisees or formal arrangements directly between the parent and franchisees. The performance of post-sale obligations by a parent's employee for the benefit of franchisees does not trigger the Item 21 parent financial disclosures, absent a formal commitment or guarantee on the part of the parent to perform.

¹ The Commission staff will look to SEC rules and policies when determining what constitutes "U.S. GAAS."

would narrowly allow only an American CPA to audit financial statements.

As indicated in the Rule language quoted above, in considering whether foreign accountants may audit financial statements for Franchise Rule purposes, FTC staff look to comparable federal policies regarding public companies in the securities area. In this regard, the Sarbanes-Oxley Act of 2002 established the Public Company Accounting Oversight Board (“PCAOB”), which, among other things, is charged with setting forth and monitoring auditing standards. Section 102 of that Act prohibits accounting firms that are not registered with the PCAOB from preparing or issuing audit reports on U.S. public companies and from participating in such audits. Further, section 106(a) of the Act provides that any non-U.S. public accounting firm that prepares or furnishes an audit report with respect to any U.S. public company is subject to the Board’s rules to the same extent as a U.S. public accounting firm. Therefore, in accordance with Sarbanes-Oxley, FTC staff believe that, at the very least, any foreign accounting firm seeking to audit financial statements for purposes of the Franchise Rule must register with the PCAOB.

Foreign PCAOB registered accountants are subject to the same auditing standards as American PCAOB registered accountants. Under SEC rules, financial statements must be prepared using GAAP (or in accordance with another comprehensive basis of accounting standards, with an audited reconciliation to U.S. GAAP).² In addition, foreign auditors, like their American counterparts, must satisfy independence requirements.³ Foreign accountants are also subject to enforcement actions for any violation of federal securities laws.

In addition to satisfying PCAOB registration requirements and SEC accounting and auditing standards for public companies, foreign accountants wishing to audit financial statements under the Franchise Rule must meet any additional qualifications imposed by the SEC. This includes a review of the foreign accountant’s quality controls, personnel qualifications, knowledge of professional standards, and recent audit performance. This review is typically conducted by a consultant retained by the foreign accounting firm. The foreign accountant must have all filings with the SEC that contain its audit report reviewed by an American or foreign accountant knowledgeable with respect to U.S. GAAP, PCAOB standards and requirements, and SEC rules and regulations. Currently, that means that the reviewing accounting firm must determine, among other things, that the filings have been prepared using U.S. GAAP and audits have been prepared using U.S. GAAS.⁴ The reviewing accounting firm, however, reviews the filing only and need not perform a complete audit on the reviewed material.

Applying these principles, Commission staff believes that foreign accountants or accounting firms may audit financial statements for Franchise Rule purposes consistent with PCAOB and SEC policies. That means that all foreign accounting firms wishing to

² 17 C.F.R. § 210.2-02(b).

³ 17 C.F.R. § 210.2-01.

⁴ Commission staff recognizes that SEC rules and policies may change with respect to what constitutes generally accepted auditing standards. We intend to interpret the Franchise Rule’s accounting, as well as auditing standards, consistent with SEC practice.

prepare audited financials under the Franchise Rule must: (1) be registered with PCAOB; and (2) recently have audited one or more financial statements that have been filed and accepted by the SEC.

18. Does Item 8 of the amended Rule require the disclosure of a *de minimis* ownership interest in a supplier by an officer of the franchisor, and is there a threshold level of ownership that triggers disclosure.

Answer: A *de minimis* ownership interest that would not be “material” to an investment decision by a prospective franchisee need not be disclosed in Item 8. 16 C.F.R. § 436.5(h)(3); see 72 FR 15444, 15487-88 & n.451 (Mar. 30, 2007). The question of whether an officer’s interest in a supplier is “material,” however, is a factual one that necessarily requires consideration of all the facts and circumstances, and cannot be answered in the abstract. Consequently, there can be no fixed “threshold” level of ownership that would uniformly provide a safe harbor for officers with a financial interest below a specified level.

Generally, it can be said that the more direct an officer’s ownership interest is in a supplier, such as ownership of a controlling interest in the supplier’s stock, the more likely it is that staff would deem the ownership interest to be material. Conversely, the more indirect and attenuated the ownership interest, the less likely it is that the interest would be deemed material. Thus, for example, if an officer of a franchisor owns shares of a diversified mutual fund that does not have a stated policy of concentrating its investments in a particular industry or line of business, the fact that the fund may acquire and hold stock in a supplier would not trigger the disclosure requirement.

It is worth emphasizing that the requirement does not demand disclosure of the identity of the officer with the ownership interest, or even the extent of the interest. It only requires the identification of “any supplier” from which franchisees are required to make a purchase in which an officer of the franchisor owns “an interest.” Franchisors therefore would be well advised, in assessing the materiality of an officer’s interest, to err on the side of disclosure.

19. Does Item 20 of the amended Rule require franchisors to disclose the names of franchisees that have binding franchise agreements, but have not opened an outlet, and of former franchisees who never opened an outlet?

Answer: Yes. Item 20 requires franchisors to: “[d]isclose the names of *all current franchisees* and the address and telephone number of each of their outlets,” 16 C.F.R. § 436.5(t)(4) (emphasis added). Item 20 also requires franchisors to “[d]isclose the name, city and state, and current business telephone number, or if unknown, the last known home telephone number of every [former] *franchisee*.” 16 C.F.R. § 436.5(t)(5).

Section 436.1(i) of the amended Rule defines “franchisee” as “any person who is granted a franchise.” 16 CFR 436.1(i). The breadth of this definition of “franchisee” unquestionably includes current franchisees who have valid and enforceable franchise agreements, but have not yet opened an outlet, as well as former franchisees who never opened an outlet. Similarly, it includes non-traditional franchised businesses where there may be no physical outlet (e.g., an Internet business).

In making the required disclosure for current franchisees, franchisors may not be able to disclose “the address and telephone number” for an outlet that has not yet opened or where no physical outlet is required to operate the business. Where no outlet has opened, the required disclosure can be made by listing the name of the franchisee, the city and state where the franchise will be located (if a location has not yet been determined), and noting that an outlet has “not yet opened.” If the franchisee has a business telephone number or email address where he or she can be contacted, that information should be provided in place of the telephone number of the outlet, since the purpose of this disclosure is to enable prospective franchisees to contact existing franchisees.

In making this disclosure for a current franchise that does not need a physical outlet to operate the franchise, the franchisor can comply by listing the name of the franchisee and noting that “no physical outlet exists.” In this case, however, the franchisor should also disclose a business address and business telephone number for the franchisee, if either exists. If not, the franchisor should disclose the city and state where the franchisee is located together with an internet website address or email address where the franchisee can be contacted.

Similar information about a former franchisee who never opened an outlet, or whose franchise did not require a physical outlet, must be included in the separate listing of former franchisees in Item 20. In making that disclosure, however, a franchisor is required to disclose the franchisee’s last known home telephone number if a reasonable effort to obtain a current business telephone number is unsuccessful. If a former franchisee requests that alternative contact information be disclosed – such as an email address, post office address, or personal home address – then it is not a violation of the Franchise Rule for a franchisor to honor the request and substitute the alternative contact information for the last known home telephone number.

20. When a franchise broker seeks to induce franchise purchases by independently offering a rebate or similar payment from its own funds, must a franchisor disclose that fact? May such a rebate offer be limited in its duration?

Answer: As a general matter, a Franchise Disclosure Document (“FDD”) must include information about a franchise broker only if the broker both “grants a franchise and participates in the franchise relationship.” Thus, unless a broker is a party to a franchise agreement under which it has post sale obligations to the franchisee, it is not a “subfranchisor” subject to disclosure obligations under the Rule. 16 C.F.R. § 436.1(k).

If, as is more typical, a franchise broker has no contractual post-sale obligations to the franchisee, it does not “participate in the franchise relationship” and disclosures about the broker are not required by the Rule. Consequently, if such a broker chooses to offer a rebate or similar payment from its own funds independently of the franchisor, and does not receive a sales commission from the franchisor that has been inflated to cover the cost of the offered payment, nothing in the Rule would require the franchisor to disclose the broker’s offer of a rebate or similar payment in its disclosure document.

Similarly, nothing in the Rule would ordinarily restrict a broker’s freedom to limit the duration of a rebate or similar offer. It is important to note, however, that a franchise broker is a “franchise seller” under the Rule because it “offers for sale, sells, or arranges for the sale of a franchise.” 16 C.F.R. § 436.1(j). As such, a broker is subject to three

Rule prohibitions that could be implicated if the impending expiration of a short-term rebate offer were to deprive a prospective franchisee of the rights these prohibitions are designed to protect: (1) The right to obtain a copy of the franchisor's most recent disclosure document and quarterly updates upon reasonable request before signing a franchise agreement (16 C.F.R. § 436.9(f)); (2) The right to review a franchise agreement that differs materially from the agreement attached to the FDD for at least seven days before signing it (16 C.F.R. § 436.9(d)); and (3) The right not to have to disclaim or waive reliance on the representations made by the franchisor in the FDD.

21. May a franchisor require a prospective franchisee to list the statements in the franchisor's disclosure document that he or she regards as material to his or her decision to sign the franchise agreement?

Answer: No. Under the Franchise Rule, a prospective franchisee is entitled to regard as material each and every statement in a franchise disclosure document. The text of the Rule as well as the Compliance Guide make it clear that section 436.9(h) reflects a Commission finding that each disclosure required by the Rule is material to a prospective franchisee's investment decision.

Specifically, a "franchise seller" may not "require a prospective franchisee to waive reliance on any representation made in the disclosure document or in its exhibits or amendments." 16 C.F.R. § 436.9(h). (The definition of "franchise seller" in section 436.1(j) specifies that this term "includes the franchisor and the franchisor's employees," among others.) Forcing a prospective franchisee to designate certain select statements as "material" would invite the conclusion that statements not selected are not material, and a court reasonably could construe a franchisee's failure to select one or more particular statements as the prospective franchisee's waiver of reliance on those particular statements.

Therefore, any requirement that a prospective franchisee provide a list of the statements from the franchisor's disclosure document that the prospective franchisee regards as material would be contrary to the express terms of the prohibition in section 436.9(h), and would seek to accomplish indirectly what that provision directly prohibits.

22. If a prospective franchisee has received a UFOC disclosure document prior to July 1, 2008, but has not purchased a franchise by that date, must the franchisor provide the prospective franchisee with its Franchise Disclosure Document ("FDD") 14 calendar days before he or she pays any money or signs a binding agreement in connection with the proposed franchise sale?

Answer: The Rule does not require a franchisor to give its FDD to a prospective franchisee who has already received a UFOC disclosure document prior to July 1, 2008, unless he or she makes a reasonable request for the most recent disclosure document and quarterly updates pursuant to Section 436.9(f) of the Rule.

23. Must a franchisor identify more than a single individual as a "franchise seller" on its Item 23 receipt, or must a franchisor supplement the receipt page if that is necessary to list every individual with whom a prospective franchisee has

significant contacts before the sale is concluded? If any supplementation is required, would it trigger a new 14 calendar day waiting period before a sale may be completed, or may the supplementation be accomplished at the closing of a sale by requiring a purchaser to list all the individual franchise sellers with whom she has had significant contacts?

Answer: As FAQ 12 indicates, franchisors must identify and include contact information in the Item 23 receipt for “each franchise seller offering the franchise.” Unless a potential purchaser deals with only one individual before buying the franchise, identifying a single individual as the “franchise seller” may not comply with the requirement, and supplementation of the list of franchise sellers may be necessary to include any individual with whom the purchaser has had significant contacts – that is, contacts in which material representations are made about the franchise.

FAQ 12 emphasizes that in preparing their disclosures, franchisors must limit the Item 23 receipt’s identification of franchise sellers to the individuals with whom a particular potential purchaser actually has had or is reasonably likely to have significant contacts, rather than including every single franchise seller with whom any prospective franchisee in the U.S. might have some contact. Since not all of the individual franchise sellers with whom a particular potential purchaser may have significant contacts may be known at the time a franchisor furnishes the disclosure, FAQ 12 suggests several ways in which the receipt page may be supplemented to add or update the required disclosure before a sale is concluded. Any such supplementation will not trigger a new 14 calendar day waiting period because it does not alter the substantive disclosures required by the Rule.

Item 23 places the burden on the franchisor, not on a prospective franchisee, to identify franchise sellers on the receipt page. As FAQ 12 suggests, it may be reasonable in some circumstances for franchisors to request a prospective franchisee’s assistance in identifying which individual franchise sellers in their local area they have dealt with, but that is not to say that franchisors may shift the disclosure burden of identifying franchise sellers to prospective franchisees. If, for example, a franchisor invites prospective franchisees to its headquarters for one or more days of discussions concluding with a franchise sale, as is not uncommon, the franchisor should know which of its officers and employees will have significant contacts with the prospect during those discussions.

- 24. Does a franchisor risk violating section 436.9(e) of the Rule if a prospective franchisee makes a reasonable request for the franchisor’s Franchise Disclosure Document (“FDD”) earlier in the sales process than required by section 436.2, but at a time when an applicable state franchise investment law prohibits the franchisor from providing its FDD to that prospect until an amendment reflecting a material change has been filed with or made effective by the state?**

Answer: As a matter of enforcement policy, Commission staff would not recommend initiation of an action to enforce section 436.9(e) in such a circumstance if the franchisor can demonstrate that it: (1) advised the prospective franchisee that it was revising its FDD to reflect a material change; and (2) delivered the revised FDD as soon as permitted by the applicable state law, but in any event at least 14 calendar days before the prospective franchisee signed a binding agreement with, or made a payment to the franchisor or an affiliate in connection with the proposed franchise sale.

FAQ 14 generally deals with this situation, and provides advice applicable in most states. However, FAQ 14 does not address the existence of some state franchise investment laws that do not permit the delivery of disclosures after a material change has occurred until revised disclosures reflecting the change have been filed with the state or reviewed and made effective by state regulators.

As FAQ 14 notes, nothing in the Rule requires a franchisor to stop offering and selling franchises while it is in the process of updating its disclosures to reflect a material change. However, the same cannot be said for state franchise investment laws. Consequently, Commission staff will not recommend initiation of enforcement actions in the circumstances discussed above.

25. Item 12 requires that a franchisor that does not provide an exclusive territory include a disclaimer underscoring that fact. What constitutes an “exclusive territory” that would permit a franchisor to omit this disclaimer?

Answer: In accordance with its well-established usage in franchising, Commission staff construe the term “exclusive territory” to mean a geographic area granted to a franchisee within which the franchisor promises not to establish either a company-owned or franchised outlet selling the same or similar goods or services under the same or similar trademarks or service marks.

If a franchise agreement omits either aspect of this two-fold commitment (neither company-owned nor franchised outlets within the territory), section 436.5(l)(5)(i) of the Rule requires the franchisor to insert the following disclaimer in Item 12:¹

You will not receive an exclusive territory. You may face competition from other franchisees, from outlets that we own, or from other channels of distribution or competitive brands that we control.

Requiring the disclaimer quoted above when the franchisor does not establish company-owned or franchised outlets within the territory – but does reserve the right to make sales in that territory through alternative channels of distribution or competitive brands – would be inconsistent with the disclosure scheme in Item 12. In the case of both exclusive **and** non-exclusive territories, sections 436.5(l)(6)(i) and (iii) of the Rule separately require detailed disclosures about whether a franchisor reserves the right to sell through alternative channels or competitive brands. Consequently, the disclaimer is not necessary to prevent prospective franchisees from mistakenly believing that an exclusive territory includes protection against competition by the franchisor by either of those means.

With exclusive territory so construed, Commission staff believe that any explanatory footnotes to the disclaimer will be unnecessary given the requirements of sections 436.5(l)(6)(i) and (iii), and more likely to be redundant and confusing than to clarify. Thus, pursuant to § 436.6(d) of the Rule, which prohibits inclusion in the Franchise Disclosure Document of “any materials or information other than those required or

¹ Under Item 12, therefore, non-traditional franchises that cannot make any such commitment because they do not grant a geographic territory (e.g., internet-based franchises) are required to include the disclaimer.

permitted by part 436 or by state law not preempted by part 436," no explanatory footnotes should be included.

Appendix B

**NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC. (“NASAA”)
2008 FRANCHISE REGISTRATION AND DISCLOSURE GUIDELINES
(Amended and Restated UFOC Guidelines)**

On January 23, 2007, the Federal Trade Commission (“FTC”) adopted a final amended Franchise Rule (“Amended FTC Franchise Rule”). 16 C.F.R. Part 436. As of July 1, 2008, all franchisors must prepare and distribute disclosure documents that, at a minimum, comply with the disclosure format of the Amended FTC Franchise Rule. Under the Amended FTC Franchise Rule, states may impose additional requirements under state law consistent with the Amended FTC Franchise Rule.

The North American Securities Administrators Association (“NASAA”) has adopted the disclosure requirements of the Amended FTC Franchise Rule, with minimal additional requirements, as the successor to the Uniform Franchise Offering Circular Guidelines adopted on April 23, 1994. The NASAA-adopted Amended FTC Franchise Rule is attached in **Part VII**. As of July 1, 2008, Franchise Filing States will only accept for filing Franchise Disclosure Documents prepared under the Amended FTC Franchise Rule in accordance with the Instructions set forth below. This requirement does not affect any Franchise Disclosure Document registered by a Franchise Filing State before July 1, 2008 if the Franchise Disclosure Document otherwise complies with applicable state law and the Amended FTC Rule. These NASAA Franchise Registration and Disclosure Guidelines replace the NASAA Uniform Franchise Offering Circular Guidelines as of July 1, 2008.

Franchise Filing States

The “Franchise Filing States” are the states that have adopted these NASAA Guidelines.

Uniform Franchise Registration Application

Forms

In order to register a franchise in the Franchise Filing States, the following application documents must be used by a franchisor if and as required by the state:

Uniform Franchise Registration Application (Form A);

Franchisor’s Costs and Sources of Funds (Form B);

Uniform Franchise Consent to Service of Process (Form C);

Franchise Seller Disclosure Form (Form D);

Franchise Disclosure Document (see Part III below);

Application Fee (varies by Franchise Filing State);

Guarantee of Performance (if required) (Form E);

Consent of Accountant (or a photocopy of the consent) to the use of the latest audit report in the Franchise Disclosure Document (Form F);
and

Advertising or promotional materials (if required by the Franchise Filing State).

Copies of **Forms A, B, C, D, E and F** are attached in **Part V**. Instructions for preparation immediately follow each Form.

Form of Initial Application

An application for an initial registration must contain:

One copy of a complete franchise registration application, including the Franchise Disclosure Document, on paper; and

One copy of the complete franchise registration application, including Franchise Disclosure Document, on a CD-ROM, in Portable Document Format (PDF) format.

The cover letter submitting the filing must contain a representation that all of the information contained in the electronic file is identical to the paper documents. In addition, the electronic version of the Franchise Disclosure Document should be text searchable.

If a Franchise Filing State examiner requires changes to any documents submitted, the franchisor must file a complete clean copy of the revised Franchise Disclosure Document and any other revised documents, and a black-lined copy of all revised pages, unless the examiner directs otherwise. In addition to filing the complete clean Franchise Disclosure Document and black-lined pages on paper, a franchisor must include copies on a CD-ROM, in PDF format.

Do NOT use margin balloons or color highlights to show changes.

Form of Renewal or Amendment Application

An application to renew or amend a franchise registration must contain:

One copy of a complete franchise renewal or amendment application, including two copies of a complete updated or amended Franchise Disclosure Document on paper. One paper copy of the complete updated or amended Franchise Disclosure Document must be black-lined to show all additions, deletions and other changes from the applicant's previous submission; and

One copy of the complete franchise renewal or amendment application, including a clean and black-lined copy of the Franchise Disclosure Document on a CD-ROM, in PDF format.

The cover letter submitting the filing must contain a representation that all of the information contained in the electronic file is identical to the paper documents. In addition, the electronic version of the Franchise Disclosure Document should be text searchable.

If a Franchise Filing State examiner requires changes to any documents submitted, the franchisor must file a complete clean copy of the revised Franchise Disclosure Document and any other revised documents, and a black-lined copy of all revised pages, unless the examiner directs otherwise. In addition to filing the complete clean Franchise Disclosure Document and black-lined pages on paper, a franchisor must include copies on a CD-ROM, in PDF format.

Do NOT use margin balloons or color highlights to show changes.

The Franchise Disclosure Document

Format

The Franchise Disclosure Document must be prepared in the format required under the Amended FTC Franchise Rule (See **Part VII** below) and in accordance with the NASAA requirements listed below.

State Cover Page

The Franchise Disclosure Document must include the following State Cover Page prepared in accordance with these Instructions, which must immediately follow the FTC required Cover Page (See **Part VII** below):

State the following legend:

STATE COVER PAGE

Your state may have a franchise law that requires a franchisor to register or file with a state franchise administrator before offering or selling in your state. REGISTRATION OF A FRANCHISE BY A STATE DOES NOT MEAN THAT THE STATE RECOMMENDS THE FRANCHISE OR HAS VERIFIED THE INFORMATION IN THIS DISCLOSURE DOCUMENT.

Call the state franchise administrator listed in Exhibit ____ for information about the franchisor or about franchising in your state.

State the following:

MANY FRANCHISE AGREEMENTS DO NOT ALLOW YOU TO RENEW UNCONDITIONALLY AFTER THE INITIAL TERM EXPIRES. YOU MAY HAVE TO SIGN A NEW AGREEMENT WITH DIFFERENT TERMS AND CONDITIONS IN ORDER TO CONTINUE TO OPERATE YOUR BUSINESS. BEFORE YOU BUY, CONSIDER WHAT RIGHTS YOU HAVE TO RENEW YOUR FRANCHISE, IF ANY, AND WHAT TERMS YOU MIGHT HAVE TO ACCEPT IN ORDER TO RENEW.

If any of the following apply, state the following, using capital letters as shown:

Please consider the following RISK FACTORS before you buy this franchise:

THE FRANCHISE AGREEMENT REQUIRES YOU TO RESOLVE DISPUTES WITH US BY [LITIGATION/ARBITRATION/MEDIATION] ONLY IN [STATE]. OUT-OF-STATE [LITIGATION/ARBITRATION/MEDIATION] MAY FORCE YOU TO ACCEPT A LESS FAVORABLE SETTLEMENT FOR DISPUTES. IT MAY ALSO COST YOU MORE TO [LITIGATE/ARBITRATE/MEDIATE] WITH US IN [STATE] THAN IN YOUR OWN STATE.

THE FRANCHISE AGREEMENT STATES THAT [STATE] LAW GOVERNS THE AGREEMENT, AND THIS LAW MAY NOT PROVIDE THE SAME PROTECTIONS AND BENEFITS AS LOCAL LAW. YOU MAY WANT TO COMPARE THESE LAWS.

In addition to the above, disclose other risk factors required by a State Administrator.

If one or more risk factors applies, also state:

THERE MAY BE OTHER RISKS CONCERNING THIS FRANCHISE.

If you use the services of a franchise broker or referral source, state the following:

We use the services of one or more FRANCHISE BROKERS or referral sources to assist us in selling our franchise. A franchise broker or referral source represents us, not you. We pay this person a fee for selling our franchise or referring you to us. You should be sure to do your own investigation of the franchise.

(a) State the following:

Effective Date: _____

(b) Leave the effective date blank until notified of effectiveness by the state administrator.

(c) If an applicant is using a multi-state disclosure document, the applicant may list multiple state effective dates together on a separate page which is to be inserted immediately following the State Cover Page.

A sample State Cover Page and State Effective Date page are attached as **Form G** of these Instructions.

Disclosure Timing Requirements

If applicable state law requires a franchisor to provide the Franchise Disclosure Document earlier than the 14 calendar-days provided for in the Amended FTC Franchise Rule, the franchisor must add a statement to the Receipt pages of the Franchise Disclosure Document to accurately reflect the state law requirements for delivery of the disclosure document. A sample Receipt Page is attached as **Form H**.

Instructions for Preparation of the Franchise Disclosure Document

Preparation of Disclosure Documents

NASAA has adopted the following instructions for preparation of Franchise Disclosure Documents:

Disclose all required information clearly, legibly, and concisely in a single document using plain English. *Plain English* means the organization of information and language usage understandable by a person unfamiliar with the franchise business. It incorporates short sentences; definite, concrete, everyday language; active voice; and tabular presentation of information, where possible. It avoids legal jargon, highly technical business terms, and multiple negatives.

The disclosure must be in a form that permits each prospective franchisee to store, download, print, or otherwise maintain the document for future reference.

The disclosure for each Item must be separately titled and in the required order. Do not repeat the question in the disclosure document. Respond to each question fully. If the disclosure is not applicable, respond in the negative, but if an answer is required “if applicable,” or “to the extent known,” respond only if the requested information applies. Do not qualify a response with a reference to another document unless permitted by the instructions to that Item. Precede each disclosure Item with the appropriate heading.

Franchisors may prepare multi-state disclosure documents by including non-preempted, state-specific information in the text of the disclosure document or in State Addenda attached to the disclosure document. The State Addenda may be included in an exhibit attached to the Franchise Disclosure Document. Any amendments to the franchise agreement may be included in the State Addenda exhibit or in a separate exhibit immediately following the franchise agreement or document being amended.

The two copies of the Item 23 Receipt pages must be the last two pages of the Franchise Disclosure Document and attached after all the exhibits.

Before furnishing a disclosure document, the franchisor must advise the prospective franchisee of the formats in which the disclosure document is made available, any prerequisites for obtaining the disclosure document in a particular format, and any conditions necessary for reviewing the disclosure document in a particular format.

For the sole purpose of enhancing the prospective franchisee’s ability to maneuver through an electronic version of a disclosure document, the franchisor may include scroll bars, internal links, and search features. All other features (e.g., multimedia tools such as audio, video, animation, pop-up screens, or links to external information) are prohibited.

Franchisors must retain, and make available to the State Administrators, upon request, a sample copy of each materially different version of their disclosure documents for the period required by the applicable law of the Franchise Filing State.

For each completed franchise sale, franchisors must retain a copy of the signed receipt for the period required by applicable laws of the Franchise Filing States.

For each Item, type the Item's Arabic numbers and title. Identify Exhibits by a letter of the alphabet.

Separate documents (for example, a confidential operations manual) must not make representations or impose terms that contradict or are materially different from the disclosure in the Franchise Disclosure Document.

Use 8½ by 11 inch paper for the Franchise Disclosure Document and other forms submitted to the Franchise Filing States. The text of the Franchise Disclosure Document must be clearly readable and presented in at least 11 point type. Tables in the Franchise Disclosure Document and separately attached documents not prepared by the franchisor may be presented in less than 11 point type as long as the text is clearly readable.

When the applicant is a master franchisor seeking to sell master franchises (subfranchises), references in these requirements and instructions to "franchisee" include the master franchisee (subfranchisor).

The offer of master franchises (subfranchises) is an offer separate from the offer of franchises and usually requires a separate registration or exemption. A single application may register the sale of single unit and multi-unit franchises if the disclosure document is not confusing.

In an offering by a master franchisee (subfranchisor), "franchisor" means both the master franchisor and master franchisee (subfranchisor).

Master franchisees (subfranchisors) must disclose the required information about the master franchisor, and to the extent applicable, the same information concerning the master franchisee (subfranchisor).

If the franchise agreement requires a franchisee to sign a release or waiver as a condition of consenting to some future action, such as a transfer or assignment of the franchise, include a sample copy of the document the franchisee will be asked to sign. This requirement does not apply to negotiated releases or waivers that a franchisee may sign to resolve a dispute with a franchisor.

In a multi-state offering, an exhibit may list all agents for service of process. The following additional statement may be used if accurate:

“If a state is not listed, [franchisor] has not appointed an agent for service of process in that state in connection with the requirements of franchise laws. There may be states in addition to those listed above in which [franchisor] has appointed an agent for service of process.

There may also be additional agents appointed in some of the states listed.”

When state requirements conflict with these Instructions, the state requirements control. The State Administrator may modify or waive these Instructions or may require additional documentation or information.

Grossly deficient applications may be rejected summarily by the State Administrator as incomplete for filing. It is not the function of a State Administrator to prepare, in effect, an applicant’s Franchise Disclosure Document application. The additional examiner time reviewing the grossly deficient product delays the processing of diligently prepared and pursued applications.

Instructions for Updating Disclosures

NASAA has adopted the following instructions for preparation of updated disclosure documents:

When state law requires renewal or an annual report, mark “Renewal Application” or “Annual Report” on the Application page. Submit all documents required for an initial application with additions to the previously filed documents black-lined. Changes must be clearly marked so that each change is noticed easily. Do NOT use margin balloons or color highlights to show changes. Do not use less than 11 point type for changed text. Use a black-lining system that underlines changes and shows deletions by a strike through.

File a renewal application before the prior registration has expired, or as required under applicable state law. If the prior registration has expired, mark “Initial Registration of an Offer and Sale of Franchises” on the Application page and pay the fee charged for initial registrations. Black-lining and bracketing changes from the last filing will speed a re-registration. Do not mark the “Amendment” boxes on the application page on the first renewal filing even if documents are revised.

Follow the form of renewal or amendment application instructions in Part II.C. of these Guidelines.

Electronic Disclosure

Unless a Franchise Filing State has adopted its own requirements regarding electronic disclosure, franchisors may deliver a Franchise Disclosure Document electronically by complying with the NASAA Statement on Policy Regarding Electronic Delivery of Franchise Disclosure Documents, adopted September 14, 2003. A copy of the NASAA Electronic Disclosure Policy is attached in **Part VI**.

Forms

The following forms are to be used in preparation of applications and Franchise Disclosure Documents as required by the Franchise Filing States:

- Form A:** Uniform Franchise Registration Application
- Form B:** Franchisor's Costs and Sources of Funds
- Form C:** Uniform Franchise Consent to Service of Process
- Form D:** Franchise Seller Disclosure Form
- Form E:** Guarantee of Performance
- Form F:** Consent of Accountant
- Form G:** Sample State Cover Page and Sample State Effective Dates
- Form H:** Sample Receipt Page

Instructions for preparing **Forms A, B, C, D, E, F, G** and **H** follow each of those forms.

Form A – Uniform Franchise Registration Application

UNIFORM FRANCHISE REGISTRATION APPLICATION

File No. _____
(Insert file number of immediately preceding filing of Applicant)

State: _____

Fee: _____

APPLICATION FOR (Check only one):

_____ **INITIAL REGISTRATION OF AN OFFER AND SALE OF FRANCHISES**

_____ **RENEWAL APPLICATION OR ANNUAL REPORT**

_____ **PRE-EFFECTIVE AMENDMENT**

_____ **POST-EFFECTIVE MATERIAL AMENDMENT**

1. **Full legal name of Franchisor:**
2. **Name of the franchise offering:**
3. **Franchisor's principal business address:**
4. **Name and address of Franchisor's agent in this State authorized to receive service of process:**
5. **The states in which this application is or will be shortly on file:**

6. Name, address, telephone and facsimile numbers, and e-mail address of person to whom communications regarding this application should be directed:

Certification

I certify and swear under penalty of law that I have read and know the contents of this application, including the Franchise Disclosure Document with an issuance date of _____ attached as an exhibit, and that all material facts stated in all those documents are accurate and those documents do not contain any material omissions. I further certify that I am duly authorized to make this certification on behalf of the Franchisor and that I do so upon my personal knowledge.

Signed at _____, _____, 20__

Franchisor:

By: _____

Name: _____

Title: _____

Instruction for Preparing Form A – Uniform Franchise Registration Application

The Uniform Franchise Registration Application must be used for all initial, renewal and amendment filings.

1. Insert the name of the state where the filing is to be made in the first line.
2. For franchisors previously registered, insert the file number of the immediately preceding filing of the applicant in “File No.”
3. Fill in the amount of the filing fee. A check in U.S. funds drawn on a U.S. bank should accompany the Application.
4. Check one of the lines in the “Application For” section to indicate the type of filing.
5. Line 1: Insert the full legal name of the franchisor.
6. Line 2: Insert the trade name of the franchise being offered.
7. Line 3: Insert the franchisor’s principal business address in the U.S. If a foreign franchisor does not have a U.S. business address, insert its principal business address in its home jurisdiction.
8. Line 4: Insert the name and address of the franchisor’s agent in the state authorized to receive service of process. You should list the appropriate state authority listed in **Form C** (if required by the Franchise Filing State). You may also list additional agents for service of process that have been duly appointed by the franchisor.
9. Line 5: Insert the Franchise Filing States in which the application will be filed.
10. Line 6: Insert the names, address, telephone and facsimile numbers, and e-mail address of the person to whom communications regarding the Application should be directed. Identify only one individual. Confirmation of effectiveness will be sent to this address.
11. Certification: Insert the issuance date of the disclosure document, the city and state in which the Application was signed, and the date of signing. Insert the franchisor’s name in the signature block and print or type the name and title of the authorized signer. The authorized signer should sign on the “By:” line.
12. Provide a notary acknowledgment or jurat only if required by the Franchise Filing State.

Form B – Franchisor’s Costs and Sources of Funds

FRANCHISOR’S COSTS AND SOURCE OF FUNDS

1. Disclose the Franchisor’s total costs for performing its pre-opening obligations to provide goods or services in connection with establishing each franchised business, including real estate, improvements, equipment, inventory, training and other items stated in the offering:

Category	Costs
Real Estate	_____
Improvements	_____
Equipment	_____
Inventory	_____
Training	_____
Other (describe)	
_____	_____
_____	_____
_____	_____
Totals	_____

2. State separately the sources of all required funds:

**Instructions for Preparing
Form B: Franchisor's Costs and
Source of Funds**

The Franchisor's Costs and Source of Funds form should accompany each initial or renewal filing (if required by the Franchise Filing State). Do not use with amendments.

1. In Section 1, estimate the franchisor's total costs to perform its pre-opening obligations to provide goods or services for establishing a new, typical franchised business.
2. Provide only incremental cost estimates; i.e., expenses incurred that are independent of salaries and overhead for the franchisor's own employees or employees of affiliates that may provide these services.
3. In Section 2, state separately the sources of all required funds. For example, this could include the franchisor's operating funds, initial franchise fees collected, etc.

By: _____

Name: _____

Title: _____

**Instructions for Preparing
Form C – Uniform Franchise Consent to Service of Process**

The Uniform Franchise Consent to Service of Process form should accompany each initial or renewal filing. Do not use with amendments.

1. Insert the correct legal name of the franchisor, the type of entity it is (e.g., corporation, limited liability company, etc.), and the state of formation.
2. Check the line for each state in which the Application will be filed.
3. Insert the name and address of the person to whom the Franchise Filing State should provide a copy of any notice, process or pleading served on the state agency.
4. Insert the date of signing.
5. In the signature block, insert the correct legal name of the franchisor, and print or type the name and title of the authorized signer. The authorized signer should sign on the "By:" line.
6. Provide an original signed copy for each Franchise Filing State in which the application is filed (if required by the Franchise Filing State).
7. Provide a notary acknowledgment or jurat only if required by the Franchise Filing State.

Form D – Franchise Seller Disclosure Form

FRANCHISE SELLER DISCLOSURE FORM

1. List who will solicit, offer or sell franchises for the Franchisor in this state:

A. Name:

B. Business address and telephone number:

C. Present employer:

D. Present title:

E. Employment during the past five years. For each employment, state the name of the employer, position held, and beginning and ending dates:

2. State whether the person identified in 1 above:

A. Has an administrative, criminal or material civil action pending against that person alleging a violation of franchise, antitrust or securities law, or alleging fraud, unfair or deceptive practices, or any comparable allegations?

YES _____ NO _____

If you answered “yes”, please provide:

1. Names of the parties:

2. Forum, nature and current status of the pending action:

3. Case or proceeding identification number:

B. Had during the 10-year period immediately before the disclosure document’s issuance date been convicted of or pleaded nolo contendere to a felony charge; or been held liable in a civil action involving an alleged violation of a franchise, antitrust or securities law, or allegations of fraud, unfair or deceptive practices, or comparable allegations?

YES _____ NO _____

If you answered “yes”, please provide:

1. Names of the parties:

2. The forum:

3. Case or proceeding identification number:

**Form D (cont'd) – Franchise Seller Disclosure Form
Page 2**

- C. Is subject to a currently effective injunction or restrictive order or decree resulting from a pending or concluded action brought by a public agency and relating to the franchise, or to a Federal, State or Canadian franchise, securities, antitrust, trade regulation or trade practice law.**

YES _____ NO _____

If you answered “yes”, please provide:

- 1. Name of the person:**
- 2. Public agency or court:**
- 3. Case or proceeding identification number:**

Instructions for Preparing
Form D – Franchise Seller Disclosure Form

Complete one Franchise Seller Disclosure Form for each person who may be engaged in soliciting or offering or selling the franchises for the Franchisor submitting the Application. A form should be submitted for the franchisor's own employees, for the employees of its parent(s) or affiliates, and for any independent third party (e.g., broker) who may be providing sales services on its behalf in each Franchise Filing State (if required by the Franchise Filing State). Do not submit a form for the franchisor entity or master franchisee/subfranchisor entity.

1. Only provide the Franchise Filing State with Franchise Seller Disclosure Forms for those franchise sellers who will be acting on behalf of the Franchisor in that particular state.
2. In Section 1, insert the name, business address and telephone number, present employer, present title and employment of the franchise seller for the past 5 years.
3. In Section 2, answer "yes" or "no" to each question (A, B and C). If the answer is "yes" to any question, provide the requested additional information.
4. For purposes of Section 2 B., "held liable" means that, as a result of claims or counterclaims, the person must pay money or other consideration, must reduce an indebtedness by the amount of an award, cannot enforce its rights, or must take action adverse to its interest. Accordingly, dismissals concluding an adversary proceeding need not be disclosed, but a settlement resolving an adversary proceeding must be disclosed if the person is held liable as defined above.
5. If a franchise seller is no longer soliciting or offering or selling franchises on behalf of the Franchisor, promptly notify each state agency with which the Franchise Seller Disclosure Form has been filed by letter of the termination of that relationship.
6. As new franchise sellers are added, promptly submit Franchise Seller Disclosure Forms for those new franchise sellers to the state agencies for the states in which the franchise sellers will be performing services.

Form E – Guarantee of Performance

GUARANTEE OF PERFORMANCE

For value received, (name of guarantor), a (state of formation and form of entity) (the “Guarantor”), located at (address), absolutely and unconditionally guarantees to assume the duties and obligations of (name of Franchisor), located at (address) (the “Franchisor”), under its franchise registration in each state where the franchise is registered, and under its Franchise Agreement identified in its (year) Franchise Disclosure Document, as it may be amended, and as that Franchise Agreement may be entered into with franchisees and amended, modified or extended from time to time. This guarantee continues until all such obligations of the Franchisor under its franchise registrations and the Franchise Agreement are satisfied or until the liability of Franchisor to its franchisees under the Franchise Agreement has been completely discharged, whichever first occurs. The Guarantor is not discharged from liability if a claim by a franchisee against the Franchisor remains outstanding. Notice of acceptance is waived. The Guarantor does not waive receipt of notice of default on the part of the Franchisor. This guarantee is binding on the Guarantor and its successors and assigns.

The Guarantor signs this guarantee at _____, _____ on the ____ day of _____.

Guarantor:

By: _____

Name: _____

Title: _____

Instructions for Preparing Form E - Guarantee of Performance

The Guarantee of Performance form must be used if the franchisor's parent or affiliate will be guaranteeing the franchisor's performance under the Franchise Agreement. Personal guarantees of individuals are not acceptable.

1. In the opening lines, insert the correct legal name of the guarantor, its state of formation and form of the entity (*e.g.*, a Delaware corporation), and its principal business address.
2. Insert the correct legal name of the franchisor and its principal business address.
3. Insert the year corresponding to the issuance date of the Franchise Disclosure Document.
4. Insert the city and state where the Guarantee of Performance is executed and date of execution.
5. In the signature block, insert the correct legal name of the guarantor and print or type the name and title of the authorized signer. The authorized signer should sign in the "By:" line.
6. Attach a copy of the signed Guarantee of Performance to the financial statement exhibit of the Franchise Disclosure Document.

Form F – Consent of Accountant

CONSENT

_____ (Name of Accountant) _____ consents to the use in the Franchise Disclosure Document issued by _____ (name of Franchisor) _____ (“Franchisor”) on _____ (issuance date of Franchise Disclosure Document), as it may be amended, of our report dated _____ (date of accountant’s report) _____, relating to the financial statements of Franchisor for the period ending _____.

[Manual or Digital Signature of Accountant]

Instructions for Preparing Form F- Consent of Accountant

A Consent of the accountant whose audited financial statements for the last fiscal year are disclosed in the Franchise Disclosure Document must be provided with each initial or renewal filing Application. This form is a guide to drafting.

1. Prepare the Consent on the accountant's letterhead.
2. Insert the correct name of the franchisor and the Federal Trade Commission issuance date of the Franchise Disclosure Document.
3. Insert the date of the audit report for the audited financial statements.
4. Unless the Franchise Filing State requires otherwise, copies of signed Consents may be filed.

Form G- Sample State Cover Page and Sample State Effective Date Exhibit

STATE COVER PAGE

Your state may have a franchise law that requires a franchisor to register or file with a state franchise administrator before offering or selling in your state. REGISTRATION OF A FRANCHISE BY A STATE DOES NOT MEAN THAT THE STATE RECOMMENDS OR HAS VERIFIED THE INFORMATION IN THIS DISCLOSURE DOCUMENT.

Call the state franchise administrator listed in **Exhibit A** for information about the franchisor or about franchising in your state.

MANY FRANCHISE AGREEMENTS DO NOT ALLOW YOU TO RENEW UNCONDITIONALLY AFTER THE INITIAL TERM EXPIRES. YOU MAY HAVE TO SIGN A NEW AGREEMENT WITH DIFFERENT TERMS AND CONDITIONS IN ORDER TO CONTINUE TO OPERATE YOUR BUSINESS. BEFORE YOU BUY, CONSIDER WHAT RIGHTS YOU HAVE TO RENEW YOUR FRANCHISE, IF ANY, AND WHAT TERMS YOU MIGHT HAVE TO ACCEPT IN ORDER TO RENEW.

Please consider the following RISK FACTORS before you buy this franchise:

1. THE FRANCHISE AGREEMENT REQUIRES YOU TO RESOLVE DISPUTES WITH US BY ARBITRATION ONLY IN JACKSON COUNTY, MINNESOTA. OUT OF STATE ARBITRATION MAY FORCE YOU TO ACCEPT A LESS FAVORABLE SETTLEMENT FOR DISPUTES. IT MAY ALSO COST YOU MORE TO ARBITRATE WITH US IN MICHIGAN THAN IN YOUR OWN STATE.
2. THE FRANCHISE AGREEMENT REQUIRES THAT MINNESOTA LAW GOVERNS THE AGREEMENT, AND THIS LAW MAY NOT PROVIDE THE SAME PROTECTIONS AND BENEFITS AS LOCAL LAW. YOU MAY WANT TO COMPARE THESE LAWS.
3. THERE MAY BE OTHER RISKS CONCERNING THIS FRANCHISE.

We use the services of one or more FRANCHISE BROKERS or referral sources to assist us in selling our franchise. A franchise broker or referral source represents us, not you. We pay this person a fee for selling our franchise or referring you to us. You should make sure to do your own investigation of the franchise.

Effective Date: See the next page for state effective dates.

STATE EFFECTIVE DATES

The following states require that the Franchise Disclosure Document be registered or filed with the state, or be exempt from registration: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington and Wisconsin

This Franchise Disclosure Document is registered, on file or exempt from registration in the following states having franchise registration and disclosure laws, with the following effective dates:

California	April 15, 2008
Maryland	Pending
Minnesota	May 1, 2008

**Instructions for Preparing
Form G – Sample State Cover Page and
Sample State Effective Date Exhibit**

All Franchise Disclosure Documents must include a State Cover Page, which is to be attached immediately following the FTC cover page.

1. Comply with the State Cover Page instructions in Part **III.B**.
2. In the second paragraph insert the exhibit reference to the exhibit showing the list of state franchise administrators.
3. In paragraph 1 of the “Risk Factors”, insert the name of the state in which litigation or arbitration must be conducted or may be conducted. If the venue provision is not mandatory, revise the first sentence to reflect that litigation or arbitration “may” be conducted in a state other than the franchisee’s home state.
4. In paragraph 2 of the “Risk Factors”, add the name of the controlling state law.
5. Add any other Risk Factors required by a State Administrator on the State Cover Page.
6. Use the paragraph on franchise brokers only if the franchisor uses franchise brokers or sales agents to solicit or offer or sell franchises.
7. If the registration is effective in only one or a few states, the franchisor may insert the state effective dates on the State Cover Page.
8. If the franchise involves a multi-state registration with filings in numerous states, the franchisor may use a State Effective Date exhibit that must follow immediately after the State Cover Page.

List the effective date or “pending” only for those Franchise Filing States where a registration, filing or exemption has been made or is pending.

Regional franchisors may add a statement to the State Effective Date page that their territory is limited to a specific state or states.

- (c) As approvals are received, the States Effective Date page can be modified by the franchisor without any refiling with the states.

Form H—Sample Receipt Page

Receipt

This disclosure document summarizes certain provisions of the franchise agreement and other information in plain language. Read this disclosure document and all agreements carefully.

If Belmont offers you a franchise, it must provide this disclosure document to you 14 calendar-days before you sign a binding agreement with, or make a payment to, the franchisor or an affiliate in connection with the proposed franchise sale.

[Maryland, New York and Rhode Island require that we give you this disclosure document at the earlier of the first personal meeting or 10 business days before the execution of the franchise or other agreement or the payment of any consideration that relates to the franchise relationship.]

[Michigan, Oregon, and Washington require that we give you this disclosure document at least 10 business days before the execution of any binding franchise or other agreement or the payment of any consideration, whichever occurs first.]

If Belmont does not deliver this disclosure document on time or if it contains a false or misleading statement, or a material omission, a violation of federal law and state law may have occurred and should be reported to the Federal Trade Commission, Washington, DC 20580 and the state agency listed on Exhibit A.

The franchisor is Belmont Mufflers, Inc., located at 111 First Street, Jackson, MN 55000. Its telephone number is (111) 222-3333.

Issuance date: July 1, 2008.

The franchise seller for this offering is Roger Owens, Franchise Sales Director, Belmont Mufflers, Inc., 111 Capitol Street, Indianapolis, IN (123) 555-5555.

Belmont authorizes the respective state agencies identified on Exhibit B to receive service of process for it in the particular state.

I received a disclosure document dated July 1, 2008 that included the following Exhibits:

- | | |
|----------------------------------|---------------------------|
| A. State Agencies | F. Loan Agreement |
| B. Agents for Service of Process | G. List of Franchisees |
| C. Franchise Agreement | H. Terminated Franchisees |
| D. Equipment Lease | I. Financial Statements |
| E. Lease for Premises | J. State Addenda |

Date: _____
(Do not leave blank)

Signature of Prospective Franchisee

Print Name

You may return the signed receipt either by signing, dating, and mailing it to Belmont Mufflers, Inc. at 111 First Street, Jackson, MN 55000, or by faxing a copy of the signed and dated receipt to Belmont at (111) 223-3344.

Instructions for Preparing Form H – Sample Receipt Page

All Franchise Disclosure Documents must include two Receipt Pages, which are to be attached as the last pages of the disclosure document. All Exhibits to the Franchise Disclosure Document must be listed.

As long as any of the Franchise Filing States have different delivery requirements, the third and/or fourth paragraphs of the sample Receipt Page must be used in a Franchise Disclosure Document for a multi-state registration filed in the Franchise Filing States listed. If a state amends its delivery requirements to conform to the FTC's 14 calendar-day delivery rule, that state's differing delivery requirements should be deleted from the Receipt Pages.

NASAA Statement of Policy Regarding Electronic Delivery of Franchise Disclosure Documents (approved September 14, 2003)

(a) A franchisor may deliver a franchise disclosure document over the Internet or by other electronic means, or in machine-readable media, provided:

- (1) the disclosure document
 - (i) is delivered as a single, integrated, document or file;
 - (ii) has no extraneous content beyond what is required or permitted by law and by the UFOC Guidelines, but which may include customary devices for manipulating electronic documents in machine readable form and tools or access to tools that may be necessary or convenient to enable the recipient to receive and view the disclosure document;
 - (iii) has no links to or from external documents or content;
 - (iv) is delivered in a form that intrinsically enables the recipient to store, retrieve, and print the disclosure document; and
 - (v) conforms as to its content and format to the requirements of law;and
- (2) the franchisor
 - (i) can prove that it delivered the disclosure document electronically in compliance with this section, and that it did so at or before the time required by law; and
 - (ii) keeps records of its electronic delivery of disclosure documents and makes those records available on demand by the state franchise administrator with jurisdiction over the franchisor's offers and sales.

(b) "Delivery" requires that the disclosure document be conveyed to and received by the prospective franchisee, or that the storage media in which the disclosure document is stored be physically delivered to the prospective franchisee in accordance with subsection (a)(1).

(c) This section does not change or waive any other requirement of law concerning registration or presale disclosure of franchise offerings.

Disclosure Requirements

Attached is a copy of the requirements for preparing the contents of a Franchise Disclosure Document under these Guidelines. These requirements are substantively equivalent to the requirements adopted under the Amended FTC Franchise Rule, 16 CFR 436.3 through .5 (Subpart C), effective July 1, 2007, although the format, style, and some references have been revised for the readers' convenience.

The Franchise Disclosure Document

Definitions

Unless stated otherwise, the following definitions apply throughout these Guidelines to the extent they do not conflict with applicable state law.

(a) Action includes complaints, cross claims, counterclaims, and third-party complaints in a judicial action or proceeding, and their equivalents in an administrative action or arbitration.

(b) Affiliate means an entity controlled by, controlling, or under common control with, another entity.

(c) Confidentiality clause means any contract, order, or settlement provision that directly or indirectly restricts a current or former franchisee from discussing his or her personal experience as a franchisee in the franchisor's system with any prospective franchisee. It does not include clauses that protect franchisor's trademarks or other proprietary information.

(d) Disclose, state, describe, and list each mean to present all material facts accurately, clearly, concisely, and legibly in Plain English.

(e) Financial performance representation means any representation, including any oral, written, or visual representation, to a prospective franchisee, including a representation in the general media, that states, expressly or by implication, a specific level or range of actual or potential sales, income, gross profits, or net profits. The term includes a chart, table, or mathematical calculation that shows possible results based on a combination of variables.

(f) Fiscal year refers to the franchisor's fiscal year.

(g) Franchisee means any person who is granted a franchise.

(h) Franchise seller means a person that offers for sale, sells, or arranges for the sale of a franchise. It includes the franchisor and the franchisor's employees, representatives, agents, subfranchisors, and third-party brokers who are involved in franchise sales activities. It does not include existing franchisees who sell only their own outlet and who are otherwise not engaged in franchise sales on behalf of the franchisor.

(i) Franchisor means any person who grants a franchise and participates in the franchise relationship. Unless otherwise stated, it includes subfranchisors. For purposes of this definition, a "subfranchisor" means a person who functions as a franchisor by engaging in both pre-sale activities and post-sale performance.

(j) Parent means an entity that controls another entity directly, or indirectly through one or more subsidiaries.

(k) Person means any individual, group, association, limited or general partnership, corporation, or any other entity.

(l) Plain English means the organization of information and language usage understandable by a person unfamiliar with the franchise business. It incorporates short

sentences; definite, concrete, everyday language; active voice; and tabular presentation of information, where possible. It avoids legal jargon, highly technical business terms, and multiple negatives.

(m) Predecessor means a person from whom the franchisor acquired, directly or indirectly, the major portion of the franchisor's assets.

(n) Principal business address means the street address of a person's home office in the United States. A principal business address cannot be a post office box or private mail drop.

(o) Prospective franchisee means any person (including any agent, representative, or employee) who approaches or is approached by a franchise seller to discuss the possible establishment of a franchise relationship.

(p) Trademark includes trademarks, service marks, names, logos, and other commercial symbols.

Contents of the Franchise Disclosure Document

The Cover Page

Begin the disclosure document with a cover page, in the order and form as follows:

- (a) The title “**FRANCHISE DISCLOSURE DOCUMENT**” in capital letters and bold type.
- (b) The franchisor’s name, type of business organization, principal business address, telephone number, and, if applicable, email address and primary home page address.
- (c) A sample of the primary business trademark that the franchisee will use in its business.
- (d) A brief description of the franchised business.
- (e) The following statements:
 - (1) The total investment necessary to begin operation of a [franchise system name] franchise is [the total amount of Item 7]. This includes [the total amount in Item 5] that must be paid to the franchisor or affiliate.
 - (2) This disclosure document summarizes certain provisions of your franchise agreement and other information in plain English. Read this disclosure document and all accompanying agreements carefully. You must receive this disclosure document at least 14 calendar-days before you sign a binding agreement with, or make any payment to, the franchisor or an affiliate in connection with the proposed franchise sale. [The following sentence in bold type] **Note, however, that no governmental agency has verified the information contained in this document.**
 - (3) The terms of your contract will govern your franchise relationship. Don’t rely on the disclosure document alone to understand your contract. Read all of your contract carefully. Show your contract and this disclosure document to an advisor, like a lawyer or an accountant.
 - (4) Buying a franchise is a complex investment. The information in this disclosure document can help you make up your mind. More information on franchising, such as “[A Consumer’s Guide to Buying a Franchise](#),” which can help you understand how to use this disclosure document, is available from the Federal Trade Commission. You can contact the FTC at 1-877-FTC-HELP or by writing to the FTC at 600 Pennsylvania Avenue, NW, Washington, D.C. 20580. You can also visit the FTC’s home page at www.ftc.gov for additional information. Call your state agency or visit your public library for other sources of information on franchising.
 - (5) There may also be laws on franchising in your state. Ask your state agencies about them.
 - (6) [The issuance date].

(f) A franchisor may include the following statement between the statements set out at paragraphs (2) and (3) of the Cover Page: “You may wish to receive your disclosure document in another format that is more convenient for you. To discuss the availability of disclosures in different formats, contact [name or office] at [address] and [telephone number].”

(g) Franchisors may include additional disclosures on the cover page, on a separate cover page, or addendum to comply with state pre-sale disclosure laws.

The Table of Contents

Include the following table of contents. State the page where each disclosure Item begins. List all exhibits by letter, as shown in the following example.

Table of Contents

- 1. *The Franchisor and any Parents, Predecessors, and Affiliates***
- 2. *Business Experience***
- 3. *Litigation***
- 4. *Bankruptcy***
- 5. *Initial Fees***
- 6. *Other Fees***
- 7. *Estimated Initial Investment***
- 8. *Restrictions on Sources of Products and Services***
- 9. *Franchisee's Obligations***
- 10. *Financing***
- 11. *Franchisor's Assistance, Advertising, Computer Systems, and Training***
- 12. *Territory***
- 13. *Trademarks***
- 14. *Patents, Copyrights, and Proprietary Information***
- 15. *Obligation to Participate in the Actual Operation of the Franchise Business***
- 16. *Restrictions on What the Franchisee May Sell***
- 17. *Renewal, Termination, Transfer, and Dispute Resolution***
- 18. *Public Figures***
- 19. *Financial Performance Representations***

20. *Outlets and Franchisee Information*

21. *Financial Statements*

22. *Contracts*

23. *Receipts*

Exhibits

A. Franchise Agreement

The Disclosure Items

(a) Item 1: The Franchisor, and any Parents, Predecessors, and Affiliates.

Disclose:

(1) The name and principal business address of the franchisor; any parents; and any affiliates that offer franchises in any line of business or provide products or services to the franchisees of the franchisor.

(2) The name and principal business address of any predecessors during the 10-year period immediately before the close of the franchisor's most recent fiscal year.

(3) The name that the franchisor uses and any names it intends to use to conduct business.

(4) The identity and principal business address of the franchisor's agent for service of process.

(5) The type of business organization used by the franchisor (for example, corporation, partnership) and the state in which it was organized.

(6) The following information about the franchisor's business and the franchises offered:

- (i) Whether the franchisor operates businesses of the type being franchised.
- (ii) The franchisor's other business activities.
- (iii) The business the franchisee will conduct.
- (iv) The general market for the product or service the franchisee will offer. In describing the general market, consider factors such as whether the market is developed or developing, whether the goods will be sold primarily to a certain group, and whether sales are seasonal.
- (v) In general terms, any laws or regulations specific to the industry in which the franchise business operates.
- (vi) A general description of the competition.

(7) The prior business experience of the franchisor; any predecessors listed in Item 1, Instruction (2); and any affiliates that offer franchises in any line of business or provide products or services to the franchisees of the franchisor, including:

- (i) The length of time each has conducted the type of business the franchisee will operate.
- (ii) The length of time each has offered franchises providing the type of business the franchisee will operate.

- (iii) Whether each has offered franchises in other lines of business. If so, include:
 - (A) A description of each other line of business.
 - (B) The number of franchises sold in each other line of business.
 - (C) The length of time each has offered franchises in each other line of business.

(b) Item 2: Business Experience.

Disclose by name and position the franchisor's directors, trustees, general partners, principal officers, and any other individuals who will have management responsibility relating to the sale or operation of franchises offered by this document. For each person listed in this section, state his or her principal positions and employers during the past five years, including each position's starting date, ending date, and location.

(c) Item 3: Litigation.

(1) Disclose whether the franchisor; a predecessor; a parent or affiliate who induces franchise sales by promising to back the franchisor financially or otherwise guarantees the franchisor's performance; an affiliate who offers franchises under the franchisor's principal trademark; and any person identified in Item 2:

- (i) Has pending against that person:
 - (A) An administrative, criminal, or material civil action alleging a violation of a franchise, antitrust, or securities law, or alleging fraud, unfair or deceptive practices, or comparable allegations.
 - (B) Civil actions, other than ordinary routine litigation incidental to the business, which are material in the context of the number of franchisees and the size, nature, or financial condition of the franchise system or its business operations.
- (ii) Was a party to any material civil action involving the franchise relationship in the last fiscal year. For purposes of this Item, "franchise relationship" means contractual obligations between the franchisor and franchisee directly relating to the operation of the franchised business (such as royalty payment and training obligations). It does not include actions involving suppliers or other third parties, or indemnification for tort liability.
- (iii) Has in the 10-year period immediately before the disclosure document's issuance date:
 - (A) Been convicted of or pleaded nolo contendere to a felony charge.
 - (B) Been held liable in a civil action involving an alleged violation of a franchise, antitrust, or securities law, or involving allegations of fraud, unfair or deceptive practices, or comparable allegations.

“Held liable” means that, as a result of claims or counterclaims, the person must pay money or other consideration, must reduce an indebtedness by the amount of an award, cannot enforce its rights, or must take action adverse to its interests.

(2) Disclose whether the franchisor; a predecessor; a parent or affiliate who guarantees the franchisor’s performance; an affiliate who has offered or sold franchises in any line of business within the last 10 years; or any other person identified in Item 2 is subject to a currently effective injunctive or restrictive order or decree resulting from a pending or concluded action brought by a public agency and relating to the franchise or to a Federal, State, or Canadian franchise, securities, antitrust, trade regulation, or trade practice law.

(3) For each action identified in Instructions (1) and (2) of Item 3, state the title, case number or citation, the initial filing date, the names of the parties, the forum, and the relationship of the opposing party to the franchisor (for example, competitor, supplier, lessor, franchisee, former franchisee, or class of franchisees). Except as provided in Instruction (4) of Item 3, summarize the legal and factual nature of each claim in the action, the relief sought or obtained, and any conclusions of law or fact.¹ In addition, state:

- (i) For pending actions, the status of the action.
- (ii) For prior actions, the date when the judgment was entered and any damages or settlement terms.²
- (iii) For injunctive or restrictive orders, the nature, terms, and conditions of the order or decree.
- (iv) For convictions or pleas, the crime or violation, the date of conviction, and the sentence or penalty imposed.

(4) For any other franchisor-initiated suit identified in Instruction (1) (ii) of Item 3, the franchisor may comply with the requirements of Instruction (3) (i) through (iv) of Item 3 by listing individual suits under one common heading that will serve as the case summary (for example, “royalty collection suits”).

(d) Item 4: Bankruptcy.

(1) Disclose whether the franchisor; any parent; predecessor; affiliate; officer, or general partner of the franchisor, or any other individual who will have management responsibility relating to the sale or operation of franchises offered by this document, has, during the 10-year period immediately before the date of this disclosure document:

- (i) Filed as debtor (or had filed against it) a petition under the United States Bankruptcy Code (“Bankruptcy Code”).

¹ Franchisors may include a summary opinion of counsel concerning any action if counsel consent to use the summary opinion and the full opinion is attached to the disclosure document.

² If a settlement agreement must be disclosed in this Item, all material settlement terms must be disclosed, whether or not the agreement is confidential. However, franchisors need not disclose the terms of confidential settlements entered into before commencing franchise sales. **[purposely omitted rest of footnote]**

- (ii) Obtained a discharge of its debts under the Bankruptcy Code.
 - (iii) Been a principal officer of a company or a general partner in a partnership that either filed as a debtor (or had filed against it) a petition under the Bankruptcy Code, or that obtained a discharge of its debts under the Bankruptcy Code while, or within one year after, the officer or general partner held the position in the company.
- (2) For each bankruptcy, state:
- (i) The current name, address, and principal place of business of the debtor.
 - (ii) Whether the debtor is the franchisor. If not, state the relationship of the debtor to the franchisor (for example, affiliate, officer).
 - (iii) The date of the original filing and the material facts, including the bankruptcy court, and the case name and number. If applicable, state the debtor's discharge date, including discharges under Chapter 7 and confirmation of any plans of reorganization under Chapters 11 and 13 of the Bankruptcy Code.
- (3) Disclose cases, actions, and other proceedings under the laws of foreign nations relating to bankruptcy.

(e) Item 5: Initial Fees

Disclose the initial fees and any conditions under which these fees are refundable. If the initial fees are not uniform, disclose the range or formula used to calculate the initial fees paid in the fiscal year before the issuance date and the factors that determined the amount. For this Item, "initial fees" means all fees and payments, or commitments to pay, for services or goods received from the franchisor or any affiliate before the franchisee's business opens, whether payable in lump sum or installments. Disclose installment payment terms in this section or in Item 10.

(f) Item 6: Other Fees.

Disclose, in the following tabular form, all other fees that the franchisee must pay to the franchisor or its affiliates, or that the franchisor or its affiliates impose or collect in whole or in part for a third party. State the title "OTHER FEES" in capital letters using bold type. Include any formula used to compute the fees.³

Item 6 Table

OTHER FEES

³ If fees may increase, disclose the formula that determines the increase or the maximum amount of the increase. For example, a percentage of gross sales is acceptable if the franchisor defines the term "gross sales."

Column 1	Column 2	Column 3	Column 4
Type of fee	Amount	Due Date	Remarks

(1) In column 1, list the type of fee (for example, royalties, and fees for lease negotiations, construction, remodeling, additional training or assistance, advertising, advertising cooperatives, purchasing cooperatives, audits, accounting, inventory, transfers, and renewals).

(2) In column 2, state the amount of the fee.

(3) In column 3, state the due date for each fee.

(4) In column 4, include remarks, definitions, or caveats that elaborate on the information in the table. If remarks are long, franchisors may use footnotes instead of the remarks column. If applicable, include the following information in the remarks column or in a footnote:

- (i) Whether the fees are payable only to the franchisor.
- (ii) Whether the fees are imposed and collected by the franchisor.
- (iii) Whether the fees are non-refundable or describe the circumstances when the fees are refundable.
- (iv) Whether the fees are uniformly imposed.
- (v) The voting power of franchisor-owned outlets on any fees imposed by cooperatives. If franchisor-owned outlets have controlling voting power, disclose the maximum and minimum fees that may be imposed.

(g) Item 7: Estimated Initial Investment

Disclose, in the following tabular form, the franchisee's estimated initial investment. State the title "YOUR ESTIMATED INITIAL INVESTMENT" in capital letters using bold type. Franchisors may include additional expenditure tables to show expenditure variations caused by differences such as in site location and premises size.

Item 7 Table:

YOUR ESTIMATED INITIAL INVESTMENT

Column 1	Column 2	Column 3	Column 4	Column 5
Type of expenditure	Amount	Method of payment	When due	To whom payment is to be made

Total				
-------	--	--	--	--

- (1) In column 1:
 - (i) List each type of expense, beginning with pre-opening expenses. Include the following expenses, if applicable. Use footnotes to include remarks, definitions, or caveats that elaborate on the information in the Table.
 - (A) The initial franchise fee.
 - (B) Training expenses.
 - (C) Real property, whether purchased or leased.
 - (D) Equipment, fixtures, other fixed assets, construction, remodeling, leasehold improvements, and decorating costs, whether purchased or leased.
 - (E) Inventory to begin operating.
 - (F) Security deposits, utility deposits, business licenses, and other prepaid expenses.
 - (ii) List separately and by name any other specific required payments (for example, additional training, travel, or advertising expenses) that the franchisee must make to begin operations.
 - (iii) Include a category titled "Additional funds – [initial period]" for any other required expenses the franchisee will incur before operations begin and during the initial period of operations. State the initial period. A reasonable initial period is at least three months or a reasonable period for the industry. Describe in general terms the factors, basis, and experience that the franchisor considered or relied upon in formulating the amount required for additional funds.
- (2) In column 2, state the amount of the payment. If the amount is unknown, use a low-high range based on the franchisor's current experience. If real property costs cannot be estimated in a low-high range, describe the approximate size of the property and building and the probable location of the building (for example, strip shopping center, mall, downtown, rural, or highway).
- (3) In column 3, state the method of payment.
- (4) In column 4, state the due date.
- (5) In column 5, state to whom payment will be made.
- (6) Total the initial investment, incorporating ranges of fees, if used.
- (7) In a footnote, state:

- (i) Whether each payment is non-refundable, or describe the circumstances when each payment is refundable.
- (ii) If the franchisor or an affiliate finances part of the initial investment, the amount that it will finance, the required down payment, the annual interest rate, rate factors, and the estimated loan repayments. Franchisors may refer to Item 10 for additional details.

(h) Item 8: Restrictions on Sources of Products and Services.

Disclose the franchisee's obligations to purchase or lease goods, services, supplies, fixtures, equipment, inventory, computer hardware and software, real estate, or comparable items related to establishing or operating the franchised business either from the franchisor, its designee, or suppliers approved by the franchisor, or under the franchisor's specifications. Include obligations to purchase imposed by the franchisor's written agreement or by the franchisor's practice.⁴ For each applicable obligation, state:

- (1) The good or service required to be purchased or leased.
- (2) Whether the franchisor or its affiliates are approved suppliers or the only approved suppliers of that good or service.
- (3) Any supplier in which an officer of the franchisor owns an interest.
- (4) How the franchisor grants and revokes approval of alternative suppliers, including:
 - (i) Whether the franchisor's criteria for approving suppliers are available to franchisees.
 - (ii) Whether the franchisor permits franchisees to contract with alternative suppliers who meet the franchisor's criteria.
 - (iii) Any fees and procedures to secure approval to purchase from alternative suppliers.
 - (iv) The time period in which the franchisee will be notified of approval or disapproval.
 - (v) How approvals are revoked.
- (5) Whether the franchisor issues specifications and standards to franchisees, subfranchisees, or approved suppliers. If so, describe how the franchisor issues and modifies specifications.

⁴ Franchisors may include the reason for the requirement. Franchisors need not disclose in this Item the purchase or lease of goods or services provided as part of the franchise without a separate charge (such as initial training, if the cost is included in the franchise fee). Describe such fees in Item 5. Do not disclose fees already described in Item 6.

(6) Whether the franchisor or its affiliates will or may derive revenue or other material consideration from required purchases or leases by franchisees. If so, describe the precise basis by which the franchisor or its affiliates will or may derive that consideration by stating:

- (i) The franchisor's total revenue.⁵
- (ii) The franchisor's revenues from all required purchases and leases of products and services.
- (iii) The percentage of the franchisor's total revenues that are from required purchases or leases.
- (iv) If the franchisor's affiliates also sell or lease products or services to franchisees, the affiliates' revenues from those sales or leases.

(7) The estimated proportion of these required purchases and leases by the franchisee to all purchases and leases by the franchisee of goods and services in establishing and operating the franchised businesses.

(8) If a designated supplier will make payments to the franchisor from franchisee purchases, disclose the basis for the payment (for example, specify a percentage or a flat amount). For purposes of this disclosure, a "payment" includes the sale of similar goods or services to the franchisor at a lower price than to franchisees.

(9) The existence of purchasing or distribution cooperatives.

(10) Whether the franchisor negotiates purchase arrangements with suppliers, including price terms, for the benefit of franchisees.

(11) Whether the franchisor provides material benefits (for example, renewal or granting additional franchises) to a franchisee based on a franchisee's purchase of particular products or services or use of particular suppliers.

(i) Item 9: Franchisee's Obligations.

Disclose, in the following tabular form, a list of the franchisee's principal obligations. State the title "FRANCHISEE'S OBLIGATIONS" in capital letters using bold type. Cross-reference each listed obligation with any applicable section of the franchise or other agreement and with the relevant disclosure document provision. If a particular obligation is not applicable, state "Not Applicable." Include additional obligations, as warranted.

⁵ Take figures from the franchisor's most recent annual audited financial statement required in Item 21. If audited statements are not yet required, or if the entity deriving the income is an affiliate, disclose the sources of information used in computing revenues.

Item 9 Table:

FRANCHISEE’S OBLIGATIONS

[In bold] This table lists your principal obligations under the franchise and other agreements. It will help you find more detailed information about your obligations in these agreements and in other items of this disclosure document.

Obligation	Section in agreement	Disclosure document item
a. Site selection and acquisition/lease		
b. Pre-opening purchase/leases		
c. Site development and other pre-opening requirements		
d. Initial and ongoing training		
e. Opening		
f. Fees		
g. Compliance with standards and policies/operating manual		
h. Trademarks and proprietary information		
i. Restrictions on products/services offered		
j. Warranty and customer service requirements		
k. Territorial development and sales quotas		
l. Ongoing product/service purchases		
m. Maintenance, appearance, and remodeling requirements		
n. Insurance		
o. Advertising		
p. Indemnification		
q. Owner’s participation/management/staffing		
r. Records and reports		
s. Inspections and audits		
t. Transfer		
u. Renewal		
v. Post-termination obligations		

w. Non-competition covenants		
x. Dispute resolution		
y. Other (describe)		

(j) Item 10: Financing.

(1) Disclose the terms of each financing arrangement, including leases and installment contracts, that the franchisor, its agent, or affiliates offer directly or indirectly to the franchisee.⁶ The franchisor may summarize the terms of each financing arrangement in tabular form, using footnotes to provide additional information. For a sample Item 10 table, see Appendix A. For each financing arrangement, state:

- (i) What the financing covers (for example, the initial franchise fee, site acquisition, construction or remodeling, initial or replacement equipment or fixtures, opening or ongoing inventory or supplies, or other continuing expenses).⁷
- (ii) The identity of each lender providing financing and their relationship to the franchisor (for example, affiliate).
- (iii) The amount of financing offered or, if the amount depends on an actual cost that may vary, the percentage of the cost that will be financed.
- (iv) The rate of interest, plus finance charges, expressed on an annual basis. If the rate of interest, plus finance charges, expressed on an annual basis, may differ depending on when the financing is issued, state what that rate was on a specified recent date.
- (v) The number of payments or the period of repayment.
- (vi) The nature of any security interest required by the lender.
- (vii) Whether a person other than the franchisee must personally guarantee the debt.
- (viii) Whether the debt can be prepaid and the nature of any prepayment penalty.
- (ix) The franchisee's potential liabilities upon default, including any:
 - (A) Accelerated obligation to pay the entire amount due;

⁶ Indirect offers of financing include a written arrangement between a franchisor or its affiliate and a lender, for the lender to offer financing to a franchisee; an arrangement in which a franchisor or its affiliate receives a benefit from a lender in exchange for financing a franchise purchase; and a franchisor's guarantee of a note, lease, or other obligation of the franchisee.

⁷ Include sample copies of the financing documents as an exhibit to Item 22. Cite the section and name of the document containing the financing terms and conditions.

- (B) Obligations to pay court costs and attorney's fees incurred in collecting the debt;
 - (C) Termination of the franchise; and
 - (D) Liabilities from cross defaults such as those resulting directly from non-payment, or indirectly from the loss of business property.
- (x) Other material financing terms.

(2) Disclose whether the loan agreement requires franchisees to waive defenses or other legal rights (for example, confession of judgment), or bars franchisees from asserting a defense against the lender, the lender's assignee or the franchisor. If so, describe the relevant provisions.

(3) Disclose whether the franchisor's practice or intent is to sell, assign, or discount to a third party all or part of the financing arrangement. If so, state:

- (i) The assignment terms, including whether the franchisor will remain primarily obligated to provide the financed goods or services; and
- (ii) That the franchisee may lose all its defenses against the lender as a result of the sale or assignment.

(4) Disclose whether the franchisor or an affiliate receives any consideration for placing financing with the lender. If such payments exist:

- (i) Disclose the amount or the method of determining the payment; and
- (ii) Identify the source of the payment and the relationship of the source to the franchisor or its affiliates.

(k) Item 11: Franchisor's Assistance, Advertising, Computer Systems, and Training.

Disclose the franchisor's principal assistance and related obligations of both the franchisor and franchisee as follows. For each obligation, cite the section number of the franchise agreement imposing the obligation. Begin by stating the following sentence in bold type: **"Except as listed below, [the franchisor] is not required to provide you with any assistance."**

(1) Disclose the franchisor's pre-opening obligations to the franchisee, including any assistance in:

- (i) Locating a site and negotiating the purchase or lease of the site. If such assistance is provided, state:
 - (A) Whether the franchisor generally owns the premises and leases it to the franchisee.
 - (B) Whether the franchisor selects the site or approves an area in which the franchisee selects a site. If so, state further whether and how the franchisor must approve a franchisee-selected site.

- (C) The factors that the franchisor considers in selecting or approving sites (for example, general location and neighborhood, traffic patterns, parking, size, physical characteristics of existing buildings, and lease terms).
 - (D) The time limit for the franchisor to locate or approve or disapprove the site and the consequences if the franchisor and franchisee cannot agree on a site.
- (ii) Conforming the premises to local ordinances and building codes and obtaining any required permits.
 - (iii) Constructing, remodeling, or decorating the premises.
 - (iv) Hiring and training employees.
 - (v) Providing for necessary equipment, signs, fixtures, opening inventory, and supplies. If any such assistance is provided, state:
 - (A) Whether the franchisor provides these items directly or only provides the names of approved suppliers.
 - (B) Whether the franchisor provides written specifications for these items.
 - (C) Whether the franchisor delivers or installs these items.

(2) Disclose the typical length of time between the earlier of the signing of the franchise agreement or the first payment of consideration for the franchise and the opening of the franchisee's business. Describe the factors that may affect the time period, such as ability to obtain a lease, financing or building permits, zoning and local ordinances, weather conditions, shortages, or delayed installation of equipment, fixtures, and signs.

(3) Disclose the franchisor's obligations to the franchisee during the operation of the franchise, including any assistance in:

- (i) Developing products or services the franchisee will offer to its customers.
- (ii) Hiring and training employees.
- (iii) Improving and developing the franchised business.
- (iv) Establishing prices.
- (v) Establishing and using administrative, bookkeeping, accounting, and inventory control procedures.
- (vi) Resolving operating problems encountered by the franchisee.

(4) Describe the advertising program for the franchise system, including the following:

- (i) The franchisor's obligation to conduct advertising, including:
 - (A) The media the franchisor may use.
 - (B) Whether media coverage is local, regional, or national.
 - (C) The source of the advertising (for example, an in-house advertising department or a national or regional advertising agency).
 - (D) Whether the franchisor must spend any amount on advertising in the area or territory where the franchisee is located.
- (ii) The circumstances when the franchisor will permit franchisees to use their own advertising material.
- (iii) Whether there is an advertising council composed of franchisees that advises the franchisor on advertising policies. If so, disclose:
 - (A) How members of the council are selected.
 - (B) Whether the council serves in an advisory capacity only or has operational or decision-making power.
 - (C) Whether the franchisor has the power to form, change, or dissolve the advertising council.
- (iv) Whether the franchisee must participate in a local or regional advertising cooperative. If so, state:
 - (A) How the area or membership of the cooperative is defined.
 - (B) How much the franchisee must contribute to the fund and whether other franchisees must contribute a different amount or at a different rate.
 - (C) Whether the franchisor-owned outlets must contribute to the fund and, if so, whether those contributions are on the same basis as those for franchisees.
 - (D) Who is responsible for administering the cooperative (for example, franchisor, franchisees, or advertising agency).
 - (E) Whether cooperatives must operate from written governing documents and whether the documents are available for the franchisee to review.
 - (F) Whether cooperatives must prepare annual or periodic financial statements and whether the statements are available for review by the franchisee.

- (G) Whether the franchisor has the power to require cooperatives to be formed, changed, dissolved, or merged.
- (v) Whether the franchisee must participate in any other advertising fund. If so, state:
 - (A) Who contributes to the fund.
 - (B) How much the franchisee must contribute to the fund and whether other franchisees must contribute a different amount or at a different rate.
 - (C) Whether the franchisor-owned outlets must contribute to the fund and, if so, whether it is on the same basis as franchisees.
 - (D) Who administers the fund.
 - (E) Whether the fund is audited and when it is audited.
 - (F) Whether financial statements of the fund are available for review by the franchisee.
 - (G) How the funds were used in the most recently concluded fiscal year, including the percentages spent on production, media placement, administrative expenses, and a description of any other use.
- (vi) If not all advertising funds are spent in the fiscal year in which they accrue, how the franchisor uses the remaining amount, including whether franchisees receive a periodic accounting of how advertising fees are spent.
- (vii) The percentage of advertising funds, if any, that the franchisor uses principally to solicit new franchise sales.

(5) Disclose whether the franchisor requires the franchisee to buy or use electronic cash registers or computer systems. If so, describe the systems generally in non-technical language, including the types of data to be generated or stored in these systems, and state the following:

- (i) The cost of purchasing or leasing the systems.
- (ii) Any obligation of the franchisor, any affiliate, or third party to provide ongoing maintenance, repairs, upgrades, or updates.
- (iii) Any obligations of the franchisee to upgrade or update any system during the term of the franchise, and, if so, any contractual limitations on the frequency and cost of the obligation.
- (iv) The annual cost of any optional or required maintenance, updating, upgrading, or support contracts.

- (v) Whether the franchisor will have independent access to the information that will be generated or stored in any electronic cash register or computer system. If so, describe the information that the franchisor may access and whether there are any contractual limitations on the franchisor's right to access the information.

(6) Disclose the table of contents of the franchisor's operating manual provided to franchisees as of the franchisor's last fiscal year-end or a more recent date. State the number of pages devoted to each subject and the total number of pages in the manual as of this date. This disclosure may be omitted if the franchisor offers the prospective franchisee the opportunity to view the manual before buying the franchise.

(7) Disclose the franchisor's training program as of the franchisor's last fiscal year-end or a more recent date.

- (i) Describe the training program in the following tabular form. Title the table "TRAINING PROGRAM" in capital letters and bold type.

Item 11 Table

TRAINING PROGRAM

Column 1	Column 2	Column 3	Column 4
Subject	Hours of Classroom Training	Hours of On-The-Job Training	Location

- (A) In column 1, state the subjects taught.
 - (B) In column 2, state the hours of classroom training for each subject.
 - (C) In column 3, state the hours of on-the-job training for each subject.
 - (D) In column 4, state the location of the training for each subject.
- (ii) State further:
- (A) How often training classes are held and the nature of the location or facility where training is held (for example, company, home, office, franchisor-owned store).
 - (B) The nature of instructional materials and the instructor's experience, including the instructor's length of experience in the field and with the franchisor. State only experience relevant to the subject taught and the franchisor's operations.
 - (C) Any charges franchisees must pay for training and who must pay travel and living expenses of the training program enrollees.

- (D) Who may and who must attend training. State whether the franchisee or other persons must complete the program to the franchisor's satisfaction. If successful completion is required, state how long after signing the agreement or before opening the business the training must be completed. If training is not mandatory, state the percentage of new franchisees that enrolled in the training program during the preceding 12 months.
- (E) Whether additional training programs or refresher courses are required.

(I) Item 12: Territory.

Disclose:

- (1) Whether the franchise is for a specific location or a location to be approved by the franchisor.
- (2) Any minimum territory granted to the franchisee (for example, a specific radius, a distance sufficient to encompass a specified population, or another specific designation).
- (3) The conditions under which the franchisor will approve the relocation of the franchised business or the franchisee's establishment of additional franchised outlets.
- (4) Franchisee options, rights of first refusal, or similar rights to acquire additional franchises.
- (5) Whether the franchisor grants an exclusive territory.
 - (i) If the franchisor does not grant an exclusive territory, state: "You will not receive an exclusive territory. You may face competition from other franchisees, from outlets that we own, or from other channels of distribution or competitive brands that we control."
 - (ii) If the franchisor grants an exclusive territory, disclose:
 - (A) Whether continuation of territorial exclusivity depends on achieving a certain sales volume, market penetration, or other contingency, and the circumstances when the franchisee's territory may be altered. Describe any sales or other conditions. State the franchisor's rights if the franchisee fails to meet the requirements.
 - (B) Any other circumstances that permit the franchisor to modify the franchisee's territorial rights (for example, a population increase in the territory giving the franchisor the right to grant an additional franchise in the area) and the effect of such modifications on the franchisee's rights.
- (6) For all territories (exclusive and non-exclusive):

- (i) Any restrictions on the franchisor from soliciting or accepting orders from consumers inside the franchisee's territory, including:
 - (A) Whether the franchisor or an affiliate has used or reserves the right to use other channels of distribution, such as the Internet, catalog sales, telemarketing, or other direct marketing sales, to make sales within the franchisee's territory using the franchisor's principal trademarks.
 - (B) Whether the franchisor or an affiliate has used or reserves the right to use other channels of distribution, such as the Internet, catalog sales, telemarketing, or other direct marketing, to make sales within the franchisee's territory of products or services under trademarks different from the ones the franchisee will use under the franchise agreement.
 - (C) Any compensation that the franchisor must pay for soliciting or accepting orders from inside the franchisee's territory.
- (ii) Any restrictions on the franchisee from soliciting or accepting orders from consumers outside of his or her territory, including whether the franchisee has the right to use other channels of distribution, such as the Internet, catalog sales, telemarketing, or other direct marketing, to make sales outside of his or her territory.
- (iii) If the franchisor or an affiliate operates, franchises, or has plans to operate or franchise a business under a different trademark and that business sells or will sell goods or services similar to those the franchisee will offer, describe:
 - (A) The similar goods and services.
 - (B) The different trademark.
 - (C) Whether outlets will be franchisor owned or operated.
 - (D) Whether the franchisor or its franchisees who use the different trademark will solicit or accept orders within the franchisee's territory.
 - (E) The timetable for the plan.
 - (F) How the franchisor will resolve conflicts between the franchisor and franchisees and between the franchisees of each system regarding territory, customers, and franchisor support.
 - (G) The principal business address of the franchisor's similar operating business. If it is the same as the franchisor's principal business address stated in Item 1, disclose whether the franchisor maintains (or plans to maintain) physically separate offices and training facilities for the similar competing business.

(m) Item 13: Trademarks.

(1) Disclose each principal trademark to be licensed to the franchisee. For this Item, “principal trademark” means the primary trademarks, service marks, names, logos, and commercial symbols the franchisee will use to identify the franchised business. It may not include every trademark the franchisor owns.

(2) Disclose whether each principal trademark is registered with the United States Patent and Trademark Office. If so, state:

- (i) The date and identification number of each trademark registration.
- (ii) Whether the franchisor has filed all required affidavits.
- (iii) Whether any registration has been renewed.
- (iv) Whether the principal trademarks are registered on the Principal or Supplemental Register of the United States Patent and Trademark Office.

(3) If the principal trademark is not registered with the United States Patent and Trademark Office, state whether the franchisor has filed any trademark application, including any “intent to use” application or an application based on actual use. If so, state the date and identification number of the application.

(4) If the trademark is not registered on the Principal Register of the United States Patent and Trademark Office, state: “We do not have a federal registration for our principal trademark. Therefore, our trademark does not have many legal benefits and rights as a federally registered trademark. If our right to use the trademark is challenged, you may have to change to an alternative trademark, which may increase your expenses.”

(5) Disclose any currently effective material determinations of the United States Patent and Trademark Office, the Trademark Trial and Appeal Board, or any state trademark administrator or court; and any pending infringement, opposition, or cancellation proceeding. Include infringement, opposition, or cancellation proceedings in which the franchisor unsuccessfully sought to prevent registration of a trademark in order to protect a trademark licensed by the franchisor. Describe how the determination affects the ownership, use, or licensing of the trademark.

(6) Disclose any pending material federal or state court litigation regarding the franchisor’s use or ownership rights in a trademark. For each pending action, disclose:⁸

- (i) The forum and case number.
- (ii) The nature of claims made opposing the franchisor’s use of the trademark or by the franchisor opposing another person’s use of the trademark.

⁸ The franchisor may include an attorney’s opinion relative to the merits of litigation or of an action if the attorney issuing the opinion consents to its use. The text of the disclosure may include a summary of the opinion if the full opinion is attached and the attorney issuing the opinion consents to the use of the summary.

(iii) Any effective court or administrative agency ruling in the matter.

(7) Disclose any currently effective agreements that significantly limit the franchisor's rights to use or license the use of trademarks listed in this section in a manner material to the franchise. For each agreement, disclose:

- (i) The manner and extent of the limitation or grant.
- (ii) The extent to which the agreement may affect the franchisee.
- (iii) The agreement's duration.
- (iv) The parties to the agreement.
- (v) The circumstances when the agreement may be canceled or modified.
- (vi) All other material terms.

(8) Disclose:

- (i) Whether the franchisor must protect the franchisee's right to use the principal trademarks listed in this section, and must protect the franchisee against claims of infringement or unfair competition arising out of the franchisee's use of the trademarks.
- (ii) The franchisee's obligation to notify the franchisor of the use of, or claims of rights to, a trademark identical to or confusingly similar to a trademark licensed to the franchisee.
- (iii) Whether the franchise agreement requires the franchisor to take affirmative action when notified of these uses or claims.
- (iv) Whether the franchisor or franchisee has the right to control any administrative proceedings or litigation involving a trademark licensed by the franchisor to the franchisee.
- (v) Whether the franchise agreement requires the franchisor to participate in the franchisee's defense and/or indemnify the franchisee for expenses or damages if the franchisee is a party to an administrative or judicial proceeding involving a trademark licensed by the franchisor to the franchisee, or if the proceeding is resolved unfavorably to the franchisee.
- (vi) The franchisee's rights under the franchise agreement if the franchisor requires the franchisee to modify or discontinue using a trademark.

(9) Disclose whether the franchisor knows of either superior prior rights or infringing uses that could materially affect the franchisee's use of the principal trademarks in the state where the franchised business will be located. For each use of a principal trademark that the franchisor believes is an infringement that could materially affect the franchisee's use of a trademark, disclose:

- (i) The nature of the infringement.

- (ii) The locations where the infringement is occurring.
- (iii) The length of time of the infringement (to the extent known).
- (iv) Any action taken or anticipated by the franchisor.

(n) Item 14: Patents, Copyrights, and Proprietary Information.

(1) Disclose whether the franchisor owns rights in, or licenses to, patents or copyrights that are material to the franchise. Also, disclose whether the franchisor has any pending patent applications that are material to the franchise. If so, state:

- (i) The nature of the patent, patent application, or copyright and its relationship to the franchise.
- (ii) For each patent:
 - (A) The duration of the patent.
 - (B) The type of patent (for example, mechanical, process, or design).
 - (C) The patent number, issuance date, and title.
- (iii) For each patent application:
 - (A) The type of patent application (for example, mechanical, process, or design).
 - (B) The serial number, filing date, and title.
- (iv) For each copyright:
 - (A) The duration of the copyright.
 - (B) The registration number and date.
 - (C) Whether the franchisor can and intends to renew the copyright.

(2) Describe any current material determination of the United States Patent and Trademark Office, the United States Copyright Office, or a court regarding the patent or copyright. Include the forum and matter number. Describe how the determination affects the franchised business.

(3) State the forum, case number, claims asserted, issues involved, and effective determinations for any material proceeding pending in the United States Patent and Trademark Office or any court.⁹

⁹ If counsel consents, the franchisor may include a counsel's opinion or a summary of the opinion if the full opinion is attached.

(4) If an agreement limits the use of the patent, patent application, or copyright, state the parties to and duration of the agreement, the extent to which the agreement may affect the franchisee, and other material terms of the agreement.

(5) Disclose the franchisor's obligation to protect the patent, patent application, or copyright; and to defend the franchisee against claims arising from the franchisee's use of patented or copyrighted items, including:

- (i) Whether the franchisor's obligation is contingent upon the franchisee notifying the franchisor of any infringement claims or whether the franchisee's notification is discretionary.
- (ii) Whether the franchise agreement requires the franchisor to take affirmative action when notified of infringement.
- (iii) Who has the right to control any litigation.
- (iv) Whether the franchisor must participate in the defense of a franchisee or indemnify the franchisee for expenses or damages in a proceeding involving a patent, patent application, or copyright licensed to the franchisee.
- (v) Whether the franchisor's obligation is contingent upon the franchisee modifying or discontinuing the use of the subject matter covered by the patent or copyright.
- (vi) The franchisee's rights under the franchise agreement if the franchisor requires the franchisee to modify or discontinue using the subject matter covered by the patent or copyright.

(6) If the franchisor knows of any patent or copyright infringement that could materially affect the franchisee, disclose:

- (i) The nature of the infringement.
- (ii) The locations where the infringement is occurring.
- (iii) The length of time of the infringement (to the extent known).
- (iv) Any action taken or anticipated by the franchisor.

(7) If the franchisor claims proprietary rights in other confidential information or trade secrets, describe in general terms the proprietary information communicated to the franchisee and the terms for use by the franchisee. The franchisor need only describe the general nature of the proprietary information, such as whether a formula or recipe is considered to be a trade secret.

(o) Item 15: Obligation to Participate in the Actual Operation of the Franchise Business.

(1) Disclose the franchisee's obligation to participate personally in the direct operation of the franchisee's business and whether the franchisor recommends participation. Include obligations arising from any written agreement or from the franchisor's practice.

(2) If personal "on-premises" supervision is not required, disclose the following:

(i) If the franchisee is an individual, whether the franchisor recommends on-premises supervision by the franchisee.

(ii) Limits on whom the franchisee can hire as an on-premises supervisor.

(iii) Whether an on-premises supervisor must successfully complete the franchisor's training program.

(iv) If the franchisee is a business entity, the amount of equity interest, if any, that the on-premises supervisor must have in the franchisee's business.

(3) Disclose any restrictions that the franchisee must place on its manager (for example, maintain trade secrets, covenants not to compete).

(p) Item 16: Restrictions on What the Franchisee May Sell.

Disclose any franchisor-imposed restrictions or conditions on the goods or services that the franchisee may sell or that limit access to customers, including:

(1) Any obligation on the franchisee to sell only goods or services approved by the franchisor.

(2) Any obligation on the franchisee to sell all goods or services authorized by the franchisor.

(3) Whether the franchisor has the right to change the types of authorized goods or services and whether there are limits on the franchisor's right to make changes.

(q) Item 17: Renewal, Termination, Transfer, and Dispute Resolution.

Disclose, in the following tabular form, a table that cross-references each enumerated franchise relationship item with the applicable provision in the franchise or related agreement. Title the table "**THE FRANCHISE RELATIONSHIP**" in capital letters and bold type.

(1) Describe briefly each contractual provision. If a particular item is not applicable, state "Not Applicable."

(2) If the agreement is silent about one of the listed provisions, but the franchisor unilaterally offers to provide certain benefits or protections to franchisees as a matter of policy, use a footnote to describe the policy and state whether the policy is subject to change.

(3) In the summary column for Item 17(c), state what the term "renewal" means for your franchise system, including, if applicable, a statement that franchisees may be asked to sign a contract with materially different terms and conditions than their original contract.

Item 17 Table:

THE FRANCHISE RELATIONSHIP

[In bold] This table lists certain important provisions of the franchise and related agreements. You should read these provisions in the agreements attached to this disclosure document.

Provision	Section in franchise or other agreement	Summary
a. Length of the franchise term		
b. Renewal or extension of the term		
c. Requirements for franchisee to renew or extend		
d. Termination by franchisee		
e. Termination by franchisor without cause		
f. Termination by franchisor with cause		
g. "Cause" defined - curable defaults		
h. "Cause" defined - non-curable defaults		
i. Franchisee's obligations on termination/non-renewal		
j. Assignment of contract by franchisor		
k. "Transfer" by franchisee - defined		
l. Franchisor approval of transfer by franchisee		
m. Conditions for franchisor approval of transfer		
n. Franchisor's right of first refusal to acquire franchisee's business		
o. Franchisor's option to purchase franchisee's business		

p. Death or disability of franchisee		
q. Non-competition covenants during the term of the franchise		
r. Non-competition covenants after the franchise is terminated or expires		
s. Modification of the agreement		
t. Integration/merger clause		
u. Dispute resolution by arbitration or mediation		
v. Choice of forum		
w. Choice of law		

(r) Item 18: Public Figures.

Disclose:

(1) Any compensation or other benefit given or promised to a public figure arising from either the use of the public figure in the franchise name or symbol, or the public figure's endorsement or recommendation of the franchise to prospective franchisees.

(2) The extent to which the public figure is involved in the management or control of the franchisor. Describe the public figure's position and duties in the franchisor's business structure.

(3) The public figure's total investment in the franchisor, including the amount the public figure contributed in services performed or to be performed. State the type of investment (for example, common stock, promissory note).

(4) For purposes of this section, a public figure means a person whose name or physical appearance is generally known to the public in the geographic area where the franchise will be located.

(s) Item 19: Financial Performance Representations.

(1) Begin by stating the following:

The FTC's Franchise Rule permits a franchisor to provide information about the actual or potential financial performance of its franchised and/or franchisor-owned outlets, if there is a reasonable basis for the information, and if the information is included in the disclosure document. Financial performance information that differs from that included in Item 19 may be given only if: (1) a franchisor provides the actual records of an existing outlet you are considering buying; or (2) a franchisor supplements the information provided in this Item 19,

for example, by providing information about possible performance at a particular location or under particular circumstances.

(2) If a franchisor does not provide any financial performance representation in Item 19, also state:

We do not make any representations about a franchisee's future financial performance or the past financial performance of company-owned or franchised outlets. We also do not authorize our employees or representatives to make any such representations either orally or in writing. If you are purchasing an existing outlet, however, we may provide you with the actual records of that outlet. If you receive any other financial performance information or projections of your future income, you should report it to the franchisor's management by contacting [name, address, and telephone number], the Federal Trade Commission, and the appropriate state regulatory agencies.

(3) If the franchisor makes any financial performance representation to prospective franchisees, the franchisor must have a reasonable basis and written substantiation for the representation at the time the representation is made and must state the representation in the Item 19 disclosure. The franchisor must also disclose the following:

- (i) Whether the representation is an historic financial performance representation about the franchise system's existing outlets, or a subset of those outlets, or is a forecast of the prospective franchisee's future financial performance.
- (ii) If the representation relates to past performance of the franchise system's existing outlets, the material bases for the representation, including:
 - (A) Whether the representation relates to the performance of all of the franchise system's existing outlets or only to a subset of outlets that share a particular set of characteristics (for example, geographic location, type of location (such as free standing vs. shopping center), degree of competition, length of time the outlets have operated, services or goods sold, services supplied by the franchisor, and whether the outlets are franchised or franchisor-owned or operated).
 - (B) The dates when the reported level of financial performance was achieved.
 - (C) The total number of outlets that existed in the relevant period and, if different, the number of outlets that had the described characteristics.
 - (D) The number of outlets with the described characteristics whose actual financial performance data were used in arriving at the representation.

(E) Of those outlets whose data were used in arriving at the representation, the number and percent that actually attained or surpassed the stated results.

(F) Characteristics of the included outlets, such as those characteristics noted in Instruction (3)(ii)(A) of Item 19, that may differ materially from those of the outlet that may be offered to a prospective franchisee.

(iii) If the representation is a forecast of future financial performance, state the material bases and assumptions on which the projection is based. The material assumptions underlying a forecast include significant factors upon which a franchisee's future results are expected to depend. These factors include, for example, economic or market conditions that are basic to a franchisee's operation, and encompass matters affecting, among other things, a franchisee's sales, the cost of goods or services sold, and operating expenses.

(iv) A clear and conspicuous admonition that a new franchisee's individual financial results may differ from the result stated in the financial performance representation.

(v) A statement that written substantiation for the financial performance representation will be made available to the prospective franchisee upon reasonable request.

(4) If a franchisor wishes to disclose only the actual operating results for a specific outlet being offered for sale, it need not comply with this section, provided the information is given only to potential purchasers of that outlet.

(5) If a franchisor furnishes financial performance information according to this section, the franchisor may deliver to a prospective franchisee a supplemental financial performance representation about a particular location or variation, apart from the disclosure document. The supplemental representation must:

(i) Be in writing.

(ii) Explain the departure from the financial performance representation in the disclosure document.

(iii) Be prepared in accordance with the requirements of Instruction (3)(i) through (iv) of this Item 19.

(iv) Be furnished to the prospective franchisee.

(t) Item 20: Outlets and Franchisee Information.

(1) Disclose, in the following tabular form, the total number of franchised and company-owned outlets for each of the franchisor's last three fiscal years. For this Item, "outlet" includes outlets of a type substantially similar to that offered to the prospective franchisee. A sample Item 20(1) Table is attached as Appendix B.

Table No. 1

**Systemwide Outlet Summary
For years [] to []**

Column 1 Outlet Type	Column 2 Year	Column 3 Outlets at the Start of the Year	Column 4 Outlets at the End of the Year	Column 5 Net Change
Franchised	2004			
	2005			
	2006			
Company- Owned	2004			
	2005			
	2006			
Total Outlets	2004			
	2005			
	2006			

- (i) In column 1, include three outlet categories titled “franchised,” “company-owned, and “total outlets.”
- (ii) In column 2, state the last three fiscal years.
- (iii) In column 3, state the total number of each type of outlet operating at the beginning of each fiscal year.
- (iv) In column 4, state the total number of each type of outlet operating at the end of each fiscal year.
- (v) In column 5, state the net change, and indicate whether the change is positive or negative, for each type of outlet during each fiscal year.

(2) Disclose, in the following tabular form, the number of franchised and company-owned outlets and changes in the number and ownership of outlets located in each state during each of the last three fiscal years. Except as noted, each change in ownership shall be reported only once in the following tables. If multiple events occurred in the process of transferring ownership of an outlet, report the event that occurred last in time. If a single outlet changed ownership two or more times during the same fiscal year, use footnotes to describe the types of changes involved and the order in which the changes occurred.

- (i) Disclose, in the following tabular form, the total number of franchised outlets transferred in each state during each of the franchisor’s last three fiscal years. For this Item, “transfer” means the acquisition of a

controlling interest in a franchised outlet, during its term, by a person other than the franchisor or an affiliate. A sample Item 20(2) Table is attached as Appendix C.

Table No. 2

**Transfers of Outlets from Franchisees to New Owners (other than the Franchisor)
For years [] to []**

Column 1 State	Column 2 Year	Column 3 Number of Transfers
	2004	
	2005	
	2006	
	2004	
	2005	
	2006	
Total	2004	
	2005	
	2006	

- (A) In column 1, list each state with one or more franchised outlets.
 - (B) In column 2, state the last three fiscal years.
 - (C) In column 3, state the total number of completed transfers in each state during each fiscal year.
- (ii) Disclose, in the following tabular form, the status of franchisee-owned outlets located in each state for each of the franchisor's last three fiscal years. A sample Item 20(3) Table is attached as Appendix D.

Table No. 3

**Status of Franchised Outlets
For years [] to []**

Col. 1 State	Col. 2 Year	Col. 3 Outlets at Start of Year	Col. 4 Outlets Opene d	Col. 5 Termina- tions	Col. 6 Non- Renewals	Col. 7 Reacquired by Franchisor	Col. 8 Ceased Operations - Other Reasons	Col. 9 Outlets at End of the Year
	2004							
	2005							
	2006							
	2004							
	2005							
	2006							
Totals								

- (A) In column 1, list each state with one or more franchised outlets.
- (B) In column 2, state the last three fiscal years.
- (C) In column 3, state the total number of franchised outlets in each state at the start of each fiscal year.
- (D) In column 4, state the total number of franchised outlets opened in each state during each fiscal year. Include both new outlets and existing company-owned outlets that a franchisee purchased from the franchisor. (Also report the number of existing company-owned outlets that are sold to a franchisee in Column 7 of Table 4).
- (E) In column 5, state the total number of franchised outlets that were terminated in each state during each fiscal year. For purposes of this Item, "termination" means the franchisor's termination of a franchise agreement prior to the end of its term and without providing any consideration to the franchisee (whether by payment or forgiveness or assumption of debt).
- (F) In column 6, state the total number of non-renewals in each state during each fiscal year. For purposes of this Item, "non-renewal" occurs when the franchise agreement for a franchised outlet is not renewed at the end of its term.

- (G) In column 7, state the total number of franchised outlets reacquired by the franchisor in each state during each fiscal year. For purposes of this Item, a “reacquisition” means the franchisor’s acquisition for consideration (whether by payment or forgiveness or assumption of debt) of a franchised outlet during its term. (Also report franchised outlets reacquired by the franchisor in column 5 of Table 4).
- (H) In column 8, state the total number of outlets in each state not operating as one of the franchisor’s outlets at the end of each fiscal year for reasons other than termination, non-renewal, or reacquisition by the franchisor.
- (I) In column 9, state the total number of franchised outlets in each state at the end of the fiscal year.
- (iii) Disclose, in the following tabular form, the status of company-owned outlets located in each state for each of the franchisor’s last three fiscal years. A sample Item 20(4) Table is attached as Appendix E.

Table No. 4

**Status of Company-Owned Outlets
For years [] to []**

Col. 1 State	Col. 2 Year	Col. 3 Outlets at Start of the Year	Col. 4 Outlets Opened	Col. 5 Outlets Reacquired From Franchisee	Col. 6 Outlets Closed	Col. 7 Outlets Sold to Franchisee	Col. 8 Outlets at End of the Year
	2004						
	2005						
	2006						
	2004						
	2005						
	2006						
Totals	2004						
	2005						
	2006						

- (A) In column 1, list each state with one or more company-owned outlets.

- (B) In column 2, state the last three fiscal years.
- (C) In column 3, state the total number of company-owned outlets in each state at the start of the fiscal year.
- (D) In column 4, state the total number of company-owned outlets opened in each state during each fiscal year.
- (E) In column 5, state the total number of franchised outlets reacquired from franchisees in each state during each fiscal year.
- (F) In column 6, state the total number of company-owned outlets closed in each state during each fiscal year. Include both actual closures and instances when an outlet ceases to operate under the franchisor's trademark.
- (G) In column 7, state the total number of company-owned outlets sold to franchisees in each state during each fiscal year.
- (H) In column 8, state the total number of company-owned outlets operating in each state at the end of each fiscal year.

(3) Disclose, in the following tabular form, projected new franchised and company-owned outlets. A sample Item 20(5) Table is attached as Appendix F.

Table No. 5

Projected Openings As Of [Last Day of Last Fiscal Year]

Column 1	Column 2	Column 3	Column 4
State	Franchise Agreements Signed But Outlet Not Opened	Projected New Franchised Outlet In The Next Fiscal Year	Projected New Company-Owned Outlet In the Next Fiscal Year
Total			

- (i) In column 1, list each state where one or more franchised or company-owned outlets are located or are projected to be located.
- (ii) In column 2, state the total number franchise agreements that had been signed for new outlets to be located in each state as of the end of the previous fiscal year where the outlet had not yet opened.
- (iii) In column 3, state the total number of new franchised outlets in each state projected to be opened during the next fiscal year.

- (iv) In column 4, state the total number of new company-owned outlets in each state that are projected to be opened during the next fiscal year.

(4) Disclose the names of all current franchisees and the address and telephone number of each of their outlets. Alternatively, disclose this information for all franchised outlets in the state, but if these franchised outlets total fewer than 100, disclose this information for franchised outlets from contiguous states and then the next closest states until at least 100 franchised outlets are listed.

(5) Disclose the name, city and state, and current business telephone number, or if unknown, the last known home telephone number of every franchisee who had an outlet terminated, canceled, not renewed, or otherwise voluntarily or involuntarily ceased to do business under the franchise agreement during the most recently completed fiscal year or who has not communicated with the franchisor within 10 weeks of the disclosure document issuance date.¹⁰ State in immediate conjunction with this information: "If you buy this franchise, your contact information may be disclosed to other buyers when you leave the franchise system."

(6) If a franchisor is selling a previously-owned franchised outlet now under its control, disclose the following additional information for that outlet for the last five fiscal years. This information may be attached as an addendum to a disclosure document, or, if disclosure has already been made, then in a supplement to the previously furnished disclosure document.

- (i) The name, city and state, current business telephone number, or if unknown, last known home telephone number of each previous owner of the outlet;
- (ii) The time period when each previous owner controlled the outlet;
- (iii) The reason for each previous change in ownership (for example, termination, non-renewal, voluntary transfer, ceased operations); and
- (iv) The time period(s) when the franchisor retained control of the outlet (for example, after termination, non-renewal, or reacquisition).

(7) Disclose whether franchisees signed confidentiality clauses during the last three fiscal years. If so, state the following: "In some instances, current and former franchisees sign provisions restricting their ability to speak openly about their experience with [name of franchise system]. You may wish to speak with current and former franchisees, but be aware that not all such franchisees will be able to communicate with you." Franchisors may also disclose the number and percentage of current and former franchisees who during each of the last three fiscal years signed agreements that include confidentiality clauses and may disclose the circumstances under which such clauses were signed.

(8) Disclose, to the extent known, the name, address, telephone number, email address, and Web address (to the extent known) of each trademark-specific franchisee organization associated with the franchise system being offered, if such organization:

¹⁰ Franchisors may substitute alternative contact information at the request of the former franchisee, such as a home address, post office address, or a personal or business email address.

- (i) Has been created, sponsored, or endorsed by the franchisor. If so, state the relationship between the organization and the franchisor (for example, the organization was created by the franchisor, sponsored by the franchisor, or endorsed by the franchisor).
- (ii) Is incorporated or otherwise organized under state law and asks the franchisor to be included in the franchisor's disclosure document during the next fiscal year. Such organizations must renew their request on an annual basis by submitting a request no later than 60 days after the close of the franchisor's fiscal year. The franchisor has no obligation to verify the organization's continued existence at the end of each fiscal year. Franchisors may also include the following statement: "The following independent franchisee organizations have asked to be included in this disclosure document."

(u) Item 21: Financial Statements.

(1) Include the following financial statements prepared according to United States generally accepted accounting principles, as revised by any future United States government mandated accounting principles, or as permitted by the Securities and Exchange Commission. Except as provided in Instruction (2) of this Item, these financial statements must be audited by an independent certified public accountant using generally accepted United States auditing standards. Present the required financial statements in a tabular form that compares at least two fiscal years.

- (i) The franchisor's balance sheet for the previous two fiscal year-ends before the disclosure document issuance date.
- (ii) Statements of operations, stockholders equity, and cash flows for each of the franchisor's previous three fiscal years.
- (iii) Instead of the financial disclosures required by Instructions (1)(i) and (ii) of this Item 21, the franchisor may include financial statements of any of its affiliates if the affiliate's financial statements satisfy Instructions (1)(i) and (ii) of this Item 21 and the affiliate absolutely and unconditionally guarantees to assume the duties and obligations of the franchisor under the franchise agreement. The affiliate's guarantee must cover all of the franchisor's obligations to the franchisee, but need not extend to third parties. If this alternative is used, attach a copy of the guarantee to the disclosure document.
- (iv) When a franchisor owns a direct or beneficial controlling financial interest in a subsidiary, its financial statements should reflect the financial condition of the franchisor and its subsidiary.
- (v) Include separate financial statements for the franchisor and any subfranchisor, as well as for any parent that commits to perform post-sale obligations for the franchisor or guarantees the franchisor's obligations. Attach a copy of any guarantee to the disclosure document.

(2) A start-up franchise system that does not yet have audited financial statements may phase-in the use of audited financial statements by providing, at a minimum, the following statements at the indicated times:

(i) The franchisor's first partial or full fiscal year selling franchises.	An unaudited opening balance sheet.
(ii) The franchisor's second fiscal year selling franchises.	Audited balance sheet opinion as of the end of the first partial or full fiscal year selling franchises.
(iii) The franchisor's third and subsequent fiscal years selling franchises.	All required financial statements for the previous fiscal year, plus any previously disclosed audited statements that still must be disclosed according to paragraphs (1)(i) and (ii) of this Item 21.

(iv) Start-up franchisors may phase-in the disclosure of audited financial statements, provided the franchisor:

- (A) Prepares audited financial statements as soon as practicable.
- (B) Prepares unaudited statements in a format that conforms as closely as possible to audited statements.
- (C) Includes one or more years of unaudited financial statements or clearly and conspicuously discloses in this section that the franchisor has not been in business for three years or more, and cannot include all financial statements required in Instructions (1)(i) and (ii) of this Item 21.

(v) Item 22: Contracts.

Attach a copy of all proposed agreements regarding the franchise offering, including the franchise agreement and any lease, options, and purchase agreements.

(w) Item 23: Receipts.

Include two copies of the following detachable acknowledgment of receipt in the following form as the last pages of the disclosure document:

- (1) State the following:

Receipt

This disclosure document summarizes certain provisions of the franchise agreement and other information in plain language. Read this disclosure document and all agreements carefully.

If [name of franchisor] offers you a franchise, it must provide this disclosure document to you 14 calendar-days before you sign a binding agreement with, or make a payment to, the franchisor or an affiliate in connection with the proposed franchise sale.**[or sooner if required by applicable state law]**

If [name of franchisor] does not deliver this disclosure document on time or if it contains a false or misleading statement, or a material omission, a violation of federal law and state law may have occurred and should be reported to the Federal Trade Commission, Washington, D.C. 20580 and [state agency].

(2) Disclose the name, principal business address, and telephone number of each franchise seller offering the franchise.

(3) State the issuance date.

(4) If not disclosed in Item 1, state the name and address of the franchisor's registered agent authorized to receive service of process.

(5) State the following:

I received a disclosure document dated _____ that included the following Exhibits:

(6) List the title(s) of all attached Exhibits.

(7) Provide space for the prospective franchisee's signature and date.

(8) Franchisors may include any specific instructions for returning the receipt (for example, street address, email address, facsimile telephone number).

Appendix B: Sample Item 20(1) Table – Systemwide Outlet Summary

**Systemwide Outlet Summary
For years 2004 to 2006**

Column 1 Outlet Type	Column 2 Year	Column 3 Outlets at the Start of the Year	Column 4 Outlets at the End of the Year	Column 5 Net Change
Franchised	2004	859	1,062	+203
	2005	1,062	1,296	+234
	2006	1,296	2,720	+1,424
Company Owned	2004	125	145	+20
	2005	145	76	-69
	2006	76	141	+65
Total Outlets	2004	984	1,207	+223
	2005	1,207	1,372	+165
	2006	1,372	2,861	+1,489

Appendix C: Sample Item 20(2) Table – Transfers of Franchised Outlets

**Transfers of Outlets from Franchisees to New Owners (other than the Franchisor)
For years 2004 to 2006**

Column 1 State	Column 2 Year	Column 3 Number of Transfers
NC	2004	1
	2005	0
	2006	2
SC	2004	0
	2005	0
	2006	2
Total	2004	1
	2005	0
	2006	4

Appendix D: Sample Item 20(3) Table – Status of Franchise Outlets

**Status of Franchise Outlets
For years 2004 to 2006**

Col. 1 State	Col. 2 Year	Col. 3 Outlets at Start of Year	Col. 4 Outlets Opened	Col. 5 Termination s	Col. 6 Non- Renewals	Col. 7 Reacquire d by Franchisor	Col. 8 Ceased Operation s- Other Reasons	Col. 9 Outlets at End of the Year
AL	2004	10	2	1	0	0	1	10
	2005	11	5	0	1	0	0	15
	2006	15	4	1	0	1	2	15
AZ	2004	20	5	0	0	0	0	25
	2005	25	4	1	0	0	2	26
	2006	26	4	0	0	0	0	30
Totals	2004	30	7	1	0	0	1	35
	2005	36	9	1	1	0	2	41
	2006	41	8	1	0	1	2	45

Appendix E: Sample Item 20(4) Table – Status of Company-Owned Outlets

**Status of Company-Owned Outlets
For years 2004 to 2006**

Col. 1 State	Col. 2 Year	Col. 3 Outlets at Start of the Year	Col. 4 Outlets Opened	Col. 5 Outlets Reacquired From Franchisees	Col. 6 Outlets Closed	Col. 7 Outlets Sold to Franchisees	Col. 8 Outlets at End of the Year
NY	2004	1	0	1	0	0	2
	2005	2	2	0	1	0	3
	2006	3	0	0	3	0	0
OR	2004	4	0	1	0	0	5
	2005	5	0	0	2	0	3
	2006	3	0	0	0	1	2
Totals	2004	5	0	2	0	0	7
	2005	7	2	0	3	0	6
	2006	6	0	0	3	1	2

Appendix F: Sample Item 20(5) Table – Projected New Franchised Outlets

**Projected New Franchised Outlets
As of December 31, 2006**

Column 1 State	Column 2 Franchise Agreements Signed But Outlet Not Opened	Column 3 Projected New Franchised Outlet in the Next Fiscal Year	Column 4 Projected New Company-Owned Outlets in the Current Fiscal Year
CO	2	3	1
NM	0	4	2
Total	2	7	3

Appendix C

[Franchisor Letterhead]

[date]

[Prospect's Name]
[Prospect's Address]

Dear [Prospect's Name]:

We appreciate your interest in the [XYZ] franchise system. We would like to send you our Franchise Disclosure Document ("FDD"), which will provide you with additional information regarding [XYZ] and our franchise offering. This letter is to inform you that our FDD is available in multiple formats. In addition to being available in hard copy, we can send you a copy of the FDD in the following electronic format[s]:

[Add, modify or delete formats as applicable. Include any pre-requisites for obtaining the disclosure document generally or in a particular format (e.g., that the prospect is qualified to purchase the franchise) and any conditions necessary for reviewing the FDD in such format (e.g. required software, equipment, etc.)]

(a) PDF format - you will need an active e-mail account and a computer equipped with e-mail software (e.g. Outlook), Adobe Acrobat software and a printer in order to view and print the FDD.

(b) CD-ROM - you will need a computer equipped with a CD drive and a printer in order to view and print the FDD.

(c) Computer disk - you will need a computer equipped with a disk drive and a printer in order to view and print the FDD.

(d) Internet access - you can download our FDD from the following web site [www.____.com]. In order to access our FDD in this manner, you must first contact [Designated Individual] at [(____) ____ - ____] or [____@____] to obtain a password. You will also need a computer equipped with an Internet browser and a printer in order to view and print the FDD.

If you would like to receive the FDD in electronic format or have any questions please contact [Designated Individual] at [(____) ____ - ____] or [____@____]. If you elect to receive the FDD in electronic format, we will also provide a paper copy of the FDD to you if you request it.

Very truly yours,

A sample of this information, when included in a franchise application or in an e-mail:

We will send you our franchise disclosure document (FDD) as an attachment to an e-mail. You will need to have a computer, internet access, and an e-mail account at which you can receive an e-mail with a [3MB] attachment. Receiving our FDD may take awhile unless you have a broadband connection. You also need a copy of Adobe Reader, which you may already have on your computer, or which you can download for free at <http://www.adobe.com>.”

DALE E. CANTONE

Dale Cantone is an Assistant Attorney General for the State of Maryland and the Deputy Securities Commissioner for the Maryland Securities Division. Since 1996, Dale also has served as Chair of the Franchise and Business Opportunity Committee/Project Group of the North American Securities Administrators Association, Inc. ("NASAA").

Dale has spoken at programs sponsored by the American Bar Association Forum on Franchising, the International Franchise Association, the American Franchisee Association, the Direct Sellers Association, the United States Department of Commerce, the Maryland State Bar Association, the Maryland Institute for the Continuing Professional Education of Lawyers, the New York Attorney General's Office, the University of Maryland Law School, the U.S. Hispanic Chamber of Commerce, and the Better Business Bureau. He also has addressed foreign delegations from Russia and Japan on franchise related issues.

In 2001, NASAA presented Dale with its Outstanding Service Award for his work in franchising at the state level. In 2002, Dale testified about state franchise issues before the Commerce, Trade and Consumer Protection Subcommittee of the Energy and Commerce Committee of the U. S. House of Representatives. In 2005, the American Association of Franchisees and Dealer awarded Dale its Total Quality Franchising Chairman's Award for Distinguished Contributions and Service to the Franchising Community.

LEE J. PLAVE

Lee Plave is a partner in Plave Koch PLC. He has extensive experience drafting and negotiating franchise, license, and distribution agreements for international and domestic transactions, and advising clients in all aspects of franchise and distribution law.

He also counsels manufacturers, distributors, and franchisors with respect to the application of technology to franchise and distribution systems, including matters such as the development and implementation of e-commerce strategies, system-wide internet roll-out policies and procedures, cybersquatting and domain name disputes, consumer complaint and "cybergripe" web sites, unauthorized e-commerce, software and hardware licensing, and issues relating to online and internet services. His practice involves business, technology, franchise, distribution, international, and antitrust matters. In addition, Lee represents clients in matters before the Federal Trade Commission, where he served in the Enforcement Division of the Commission's Bureau of Consumer Protection from 1983-87 before entering private practice in 1987.

Lee is admitted to practice in the State of New York (1984), the District of Columbia (1987), and the Commonwealth of Virginia (2004). He is a member of the District of Columbia Bar, the New York Bar Association, the Virginia Bar Association, the American Bar Association, and the International Bar Association.

Lee has authored and co-authored numerous articles and is a frequent lecturer at business and legal conferences, seminars and programs on franchising and distribution, the internet, e-commerce, and other information technology matters. He serves on the Steering Committee of the International Franchise and Distribution Division as well as the Technology Committee of the American Bar Association Forum on Franchising, and on the IFA's Information Technology Task Force.

Lee graduated in 1980 from Clark University in Worcester, Massachusetts. In 1983, he graduated cum laude from New York Law School in New York, New York, where he served as an associate editor of the *Journal of International and Comparative Law*.

CRAIG TREGILLUS

Craig Tregillus, the Franchise Rule Coordinator at the Federal Trade Commission, previously served in that capacity from 1988 to 1994. Before joining the Commission's franchise rule staff when the original rule was issued, he had been associated with a leading franchise law firm. He has written or contributed to several articles on franchise law and a number of staff opinions interpreting the original and amended rule.

WILL K. WOODS

Will K. Woods is a partner in the Dallas office of DLA Piper. He concentrates his practice primarily in franchise and distribution law. He counsels clients on structuring international and domestic franchise transactions, distribution of products and services, and franchise registration and disclosure matters. Mr. Woods represents franchisors throughout their business life cycle: in the start-up stage; as middle-market franchisors; and as mature, global franchisors. Mr. Woods also has significant experience in negotiating complex franchise transactions and counseling clients with respect to system re-structuring and related relationship issues.

Mr. Woods is a frequent author and speaker on franchise and distribution related topics. Mr. Woods is an active member of various trade and bar associations, including the International Franchise Association and the ABA Forum on Franchising. In 2007, he was named a Rising Star by *Texas Monthly Magazine*. He was the ABA Young Lawyers Division Liaison to the ABA Forum on Franchising from 2005 to 2007.

Mr. Woods received his BBA from Baylor University in 1994 and his JD, *cum laude*, from Baylor University School of Law in 1998, where he served as Lead Articles Editor for the *Baylor Law Review*. He is a member of the Texas Bar.