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BASICS TRACK: REGISTRATION AND DISCLOSURE

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I. **Introduction**

In the United States, franchising is regulated by federal and certain state laws that govern the pre-sale registration and disclosure process with prospective franchisees, and include requirements on the preparation and delivery of a franchise disclosure document (an "FDD"), the required contents of an FDD and the registration of the franchise offering.¹ This paper is divided into five parts. First, it will address franchising laws in general, including the Federal Trade Commission's Rule on Franchising codified at 16 CFR Parts 436 and 437 (the "FTC Franchise Rule")², state laws and regulations, state business opportunity laws, and the penalties for breaching these franchise requirements. Second, this paper will provide guidance and drafting tips with respect to the disclosure items of an FDD. Third, the paper will address proper FDD disclosure procedures, including timing requirements, method of delivery, proof of compliance, the parties receiving the FDD, and when a franchisor must amend the disclosure document. Fourth, this paper will generally discuss various federal and state exemptions to pre-sale disclosure and/or registration laws that may be available under the FTC Franchise Rule or various state laws. Finally, the paper will cover miscellaneous requirements associated with the franchise sales process, including registration of various advertisements and franchise sales brokers.

II. **Disclosure Laws**

A. **FTC Franchise Rule**

The FTC Franchise Rule governs the offer and sale of franchises in the United States, including the District of Columbia and U.S. territories. The FTC Franchise Rule requires that franchisors provide certain information to prospective franchisees during the sales process and before a franchisee can sign a franchise agreement or pay compensation to the franchisor. The FTC Franchise Rule does not require the franchisor to register its FDD with any federal governing body. It is merely a law that regulates the disclosure process.

B. **State Laws and Regulations**

In addition to the disclosure obligations required by the FTC Franchise Rule, certain states have enacted separate franchise laws and regulations that impose additional state-level disclosure and registration requirements. While the original FTC Franchise Rule was enacted in 1979,³ California was the first state to enact its own franchise law in 1970, which not only required certain disclosures be made to the prospective franchisee, but also required franchisors to register the FDD with the state prior to using the FDD in the state. Many other states followed California's lead and

¹ Certain states also have state relationship laws that regulate franchisee transfers, renewals, and the termination of the franchise relationship, but this paper is focused on the pre-sale registration and disclosure process. For more information concerning state relationship laws, please see Christine E. Connelly, Aron Friedman and Mark Inzetta, *Franchise Default and Termination – Best Practices to Enforce the Contract and Protect the System*, 49th Annual Legal Symposium (2016).

²16 C.F.R. Part 436. You may view the entire FTC Franchise Rule online in the Federal Register, 72 Fed. Reg. 15444, 15544 (March 30, 2007) at <http://www.ftc.gov/os/2007/01/R511003Franchiserulefnnotice.pdf>. The actual text of the FTC Franchise Rule begins on page 15544.

³ Statement of Basis and Purpose, 43 FR 59621 (Dec. 21, 1978).

enacted laws in an effort to further protect franchisees by requiring registration of the FDD prior to selling franchises in that state.

Today, there are 14 franchise "registration states"⁴ that prohibit a franchisor from offering or selling franchises without first registering the franchise offering with the applicable state agency. Each registration state has a different application and registration process.⁵ Some states have different disclosure and timing requirements as more thoroughly discussed in Section V.A below. As part of the registration process, most registration states require a franchisor to submit its current FDD, among other things. In most (but not all) registration states, a state administrator will review the substance of the FDD and, if necessary, will respond with comments, feedback or questions. It is important to understand the variations between each registration state's regulations before attempting to register a franchise offering in that particular state.

C. Business Opportunity Laws

Pre-sale business opportunity laws govern offers of a 'business opportunity' to another party that includes a prescribed marketing plan or business strategy. Examples of business opportunities include vending machine routes, distributorships and work-at-home businesses. State business opportunity laws are drafted more broadly than franchise laws and include definitional elements that capture franchises as well. The general rule to distinguish between a business opportunity and a franchise is that while every franchise is a business opportunity, not every business opportunity is a franchise. Business opportunities are generally distinguishable from franchises in that they typically have lower startup costs and investment, less guidance or system standards, and perhaps less interaction with the offeror.

Business opportunities are regulated at the federal level by the FTC, which requires sellers to provide a disclosure document to potential buyers that includes certain information such as identifying information, earnings claims, legal actions, cancellation and refund policies, references and a receipt.⁶ 26 states also regulate business opportunities, and similar to the FTC, require that a seller provide a prospective buyer with a disclosure document, and in most states, register that

⁴ The registration states are California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington and Wisconsin.

⁵ *California Franchise Investment Law*, California Corporations Code, Div. 5, Parts 1-6, Section 31000 *et seq.*; *Hawaii Franchise Investment Law*, Hawaii Rev. Stat., Title 26, Ch. 482E, Section 482-E1 *et seq.*; *Illinois Franchise Disclosure Act*, Illinois Compiled Statutes, Ch. 815, Section 705/1 *et seq.*; *Indiana Code*, Title 23, Article 2, Ch. 2.5, Section 1 *et seq.*; *Maryland Franchise Registration and Disclosure Law*, Ann. Code of Maryland, Business Regulation, Title 14, Section 14-201 *et seq.*; *Michigan Franchise Investment Law*, Michigan Compiled Laws, Ch. 445, Section 445.1501 *et seq.*; *Minnesota Statutes*, Ch. 80C, Section 80C.01 *et seq.*; *New York General Business Law*, Art. 33, Section 680 *et seq.*; *North Dakota Franchise Investment Law*, North Dakota Century Code Ann., Title 51, Ch. 51-19, Section 51-19-01 *et seq.*; *Oregon Franchise Transactions Law*, Oregon Revised Statutes, Title 50 Ch. 650, Section 650.005 *et seq.*; *Rhode Island Franchise and Distributorship Investment Regulations Act*, General Laws of Rhode Island, Title 19, Ch. 28.1, Section 19-28.1-1 *et seq.*; *South Dakota Franchises for Brand-Name Goods and Services Law*, South Dakota Codified Laws, Title 37, Ch. 37-5B, Section 37-5B-1 *et seq.*; *Virginia Retail Franchising Act*, Virginia Code, Title 13.1, Ch. 8, Section 13.1-557 *et seq.*; *Washington Franchise Protection Act*, Revised Code of Washington, Title 19, Ch. 19.100, Section 19,100.010 *et seq.*; and *Wisconsin Franchise Investment Law*, *Wisconsin Stats.*, Ch. 553, Section 553.01 *et seq.*

⁶ 16 C.F.R. Part 437. You may view the entire FTC Business Opportunity Rule online in the Federal Register, 72 Fed. Reg. 15444, 15563 (March 30, 2007) at <http://www.ftc.gov/os/2007/01/R511003Franchiserulefrnotice.pdf>. The actual text of the FTC Business Opportunity Rule begins on page 15563.

disclosure document, prior to using it.^{7,8} In those states that regulate both franchises and business opportunities, franchises that comply with that state's franchise law generally are exempt from compliance with the business opportunity law.⁹

However, in business opportunity states that do not also have a franchise law, a franchisor is obligated to comply with that law if an exemption is not available. Fortunately for franchisors, in several of these states,¹⁰ there is an automatic exemption for franchisors who have a registered trademark.¹¹ In others,¹² an exemption is available to franchisors with a federally-registered trademark but requires the franchisor to file for the exemption with the state.¹³

D. Penalties

Franchisors are strictly liable for any violations of applicable disclosure and registration laws. Officers of the company may also be liable if they participated in the violation in a willful and fraudulent manner. Violations of the FTC Franchise Rule entitle the FTC to impose civil damages, or seek equitable remedies, such as temporary restraining orders and preliminary injunctions.¹⁴ The FTC could also refer a violator to the Department of Justice, who could pursue criminal penalties. The FTC Franchise Rule does not itself provide a private right of action, but many states have passed legislation commonly known as "Little FTC Acts," making any violation of the FTC Franchise Rule suitable grounds for private civil suits.¹⁵ In practical terms, and in the absence of FTC initiatives to pursue violations of the FTC Franchise Rule, "Little FTC Acts" offer private parties a basis upon which they may bring civil claims against a franchisor for such violations.

Several states have also passed regulations that allow their state agency to initiate proceedings against franchisors for alleged violations. This typically would occur when there are allegations of unlawful practices, misrepresentations or fraud in connection with franchise offers or sales. States have available to them many of the same remedies and penalties for violations as the FTC, but with one key difference: states are more likely to enforce penalties against a franchisor. It is rare for the FTC to enforce penalties against a franchise brand and it has not occurred in recent years.

⁷ These states include Alaska, Arizona, California, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Michigan, Minnesota, Nebraska, New Hampshire, North Carolina, Ohio, Oklahoma, South Carolina, South Dakota, Texas, Utah, Virginia, and Washington.

⁸ See, Beata Krakus and Alexander Tuneski, *Caught in the Web of Federal and State Business Opportunity Laws: Managing and Avoiding the Entanglement of Regulations*, 36th Annual Forum on Franchising (2013).

⁹ See, Kathryn A. Rookes, Brenda Beerman Trickery and Tim Goodman, *Disclosure Basics – When Discretion is not the Better Part of Valor*, 44th Annual Legal Symposium (2011).

¹⁰ Georgia, Maine, North Carolina and South Carolina.

¹¹ A federally-registered mark will provide an exemption in all business opportunity states that have a trademark exemption, though having a federally-registered trademark is not a requirement in all business opportunity states. Some states, like North Carolina and South Carolina, also have an exemption for a state-registered trademark.

¹² Connecticut, Florida, Kentucky, Nebraska, Texas and Utah.

¹³ Exemptions in CT, KY, NE and TX are perpetual, once obtained, and FL and UT require annual exemption filings.

¹⁴ *Rookes, Trickery and Goodman* at 3.

¹⁵ See, Arthur L. Pressman, Ellen R. Lokker & Eric H. Karp, *The Use of State Little FTC Acts in Franchise Relationship Litigation*, Int'l Franchise Ass'n, 31st Annual Legal Symposium (1998).

III. Contents of the Disclosure Document

Absent an exemption, an FDD is the document the FTC Franchise Rule requires a franchisor to use to sell franchises. An FDD contains (i) certain prescribed disclosures divided into 23 Items; (ii) financial statements; (iii) several exhibits that are pertinent to the franchise; and (iv) receipt pages evidencing proper disclosure and compliance with timing requirements prior to signing the franchise agreement. As detailed in Section IV(A) below, a franchisor must provide a prospective franchisee with its FDD prior to the franchisee signing a franchise agreement or providing any compensation to the franchisor. This Section III provides a general overview of the FTC Franchise Rule's disclosure requirements and Section IV focuses on the 23 disclosure Items that are required to be in the FDD.

A. General Requirements of the FDD.

The FTC Franchise Rule has general requirements that practitioners must be aware of when drafting an FDD. First, the FDD must be in plain English.¹⁶ Plain English is defined as: "the organization of information and language usage understandable by a person unfamiliar with the franchise business."¹⁷ In a practical sense, that means FDDs should be drafted using an active voice and concise sentences. FDDs should not contain legalese or contractual verbiage. Practitioners directly borrowing language from a Franchise Agreement in order to prepare the disclosures in an FDD may be particularly susceptible to including such legalese in the FDD, so should take care to rewrite such disclosures in plain English.

The FDD must be in a minimum of 11-point font. It must address each of the 23 disclosure Items but should only contain the information required by those disclosure items. The FDD should not contain any additional information that is not required by the FTC Franchise Rule or required under state law.¹⁸ If a disclosure Item does not apply to a franchisor, then the franchisor should list a negative disclosure in that Item. The FDD may include information required or permitted by a state franchise law if the information is not inconsistent with the FTC Franchise Rule. It is common for a franchisor to lump various state disclosures in the FDD in order for the franchise to have one multi-state FDD, rather than a separate FDD for each registration state. The following reference materials are helpful when drafting the FDD:¹⁹ (i) FTC Franchise Rule;²⁰ (ii) Amended Statement of Basis and Purpose;²¹ (iii) the Compliance Guide;²² (iv) FTC Franchise Rule FAQs;²³ (v) NASAA Guidelines;²⁴ (vi) NASAA Commentary on 2008 Guidelines;²⁵ (vii) NASAA Multi-

¹⁶ 16 C.F.R. §436.6(b).

¹⁷ 16 C.F.R. §436.1(o).

¹⁸ 16 C.F.R. §436.1(d).

¹⁹ See, Janaki Parmar and John Moore, *Basics Track: Registration & Disclosure*, 51st Annual Legal Symposium (2018).

²⁰ 16 C.F.R. §436.

²¹ Disclosure Requirements and Prohibitions Concerning Franchising, 72 Fed. Reg. 15,444 (March 30, 2007) or <https://www.ftc.gov/sites/default/files/070330franchiserulefnnotice.pdf>

²² <https://www.ftc.gov/system/files/documents/plain-language/bus70-franchise-rule-compliance-guide.pdf>

²³ FTC Rule FAQs, <https://www.ftc.gov/tips-advice/business-center/guidance/amended-franchise-rulefaqs>

²⁴ <http://www.nasaa.org/wp-content/uploads/2011/08/2008UFOC1.pdf>

²⁵ http://www.nasaa.org/wp-content/uploads/2011/08/FranchiseCommentary_final.pdf;

Unit Commentary;²⁶ (viii) NASAA's FPR Commentary;²⁷ and (ix) FTC Informal Advisory Opinions.²⁸

B. Federal and State Cover Pages; Table of Contents.

1. Federal Cover Page

The first page of any FDD is the federal cover page, which outlines basic information about the franchisor and the franchise offering itself. The FTC Franchise Rule requires certain language, that must be exact with respect to the order and form.²⁹ There also must be a summary of: (i) the type franchise offered, (ii) the initial investment required (as reflected in Item 7), and (iii) the initial fees payable to franchisor or its affiliates (as reflected in Item 5).³⁰ These disclosures must be followed by language and statements required by the FTC Franchise Rule, which must be verbatim as described in the FTC Franchise Rule. At the end of the federal cover page, a franchisor must include the issuance date of the FDD.³¹ The issuance date is the date that the FDD was finalized by its preparers. An example of the federal cover page is listed on Exhibit A.

2. State Cover Page

Effective January 1, 2020, the North American Securities Administrators Association ("NASAA"), which among other things seeks to unite varying franchise registration state regulations into a uniform format for disclosure, adopted a new format for the state cover pages to summarize information more clearly for franchisees and encourage franchisees to read the entire FDD. One advantage for franchisors is that states, through NASAA, have tried to universalize certain risk factors to be disclosed in the new state cover page format. The new state cover pages have three sections: (i) "How to Use This Franchise Disclosure Document;" (ii) "What You Need to Know About Franchising Generally;" and (iii) "Special Risks to Consider About This Franchise." The new format also moved the state effective dates page from immediately after the state cover page to immediately before the receipt pages. The new state cover pages and state effective dates page are also required to appear in 13-point font. Exhibit B contains sample state cover pages in the new format.

3. Table of Contents

The Table of Contents must appear directly following the state cover page. The table of contents must list the title of all 23 Items in the FDD, including all exhibits attached to the FDD.³² An example of the required Table of Contents is contained on Exhibit C.

²⁶ <http://www.nasaa.org/wp-content/uploads/2011/08/Franchise-Multi-Unit-Commentary-effective-Adopted-Sept-16-2014.pdf>

²⁷ NASAA Franchise Commentary Financial Performance Representations, <http://www.nasaa.org/wpcontent/uploads/2017/05/Financial-Performance-Representation-Commentary.pdf>

²⁸ <https://www.ftc.gov/policy/advisory-opinions>

²⁹ 16 C.F.R. §436.3.

³⁰ *Id.*

³¹ *Id.*

³² 16 C.F.R. §436.4.

IV. **Specific Disclosure Items**

This Section IV focuses on the 23 disclosure Items that are required to be in the FDD.

A. **Item 1 – The Franchisor, and any Parents, Predecessors and Affiliates.**

Item 1 is meant to provide information on the franchisor, its predecessors (within the previous 10 years), parents and affiliates that provide goods or services to franchisor's franchisees or have a history offering franchises.³³ For any entity required to be listed in Item 1, disclosures will include general information, including that entity's address, state of formation, type of business (i.e. limited liability company or corporation) and its agents for service of process (generally the government agencies in the states in which the franchisor has registered to sell franchises).³⁴ Item 1 also requires franchisors to identify their history and experience as a franchisor, including its history operating the franchise being offered or any other business. Similar disclosures are required for any predecessors or affiliates that are disclosed in Item 1.³⁵ Item 1 also requires a general description of the franchise being offered. This will most often include details surrounding the trademarks associated with the franchise, the type of business the franchise is, the goods and services the franchise offers, the market for those goods and services and whether the offering also includes multi-unit development rights. Item 1 also requires a general description of the competitive landscape in the franchise market as well as any laws or regulations that are specific to the industry in which the franchise will be operated. The description of the laws and regulations, however, does not include laws that affect all businesses generally, only those that are specific to the type of business the franchisee will operate.³⁶

B. **Item 2 – Business Experience**

Item 2 provides disclosures on each of the franchisor's directors, principal officers, and any other individuals who will have management responsibility relating to the sale or operation of the franchise offered.³⁷ FDD preparers have some latitude in determining the individuals who fall into the latter category – those with management responsibility – but in general, these are individuals who have decision-making authority for the franchise program.

Once the determination is made as to who should be included in Item 2, the required disclosures are basic. For each individual included, franchisors must include biographies that show that individual's work history for the previous five years. Practitioners often include more than 5 years' work history, but the rule requires five years and some states may comment if more than five years is included. In addition to the general work history, Item 2 must include the location of employment (City and State) for each position listed in Item 2.

³³ 16 C.F.R. §436.5(a).

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ 16 C.F.R. §436.5(b).

C. **Item 3 – Litigation**

Item 3 requires that certain types of litigation, including administrative actions, criminal actions, or material civil actions (including arbitration and injunctions) against the franchisor (collectively "Actions"), its predecessors, parents, affiliates or any individual disclosed in Item 2 be disclosed to prospective franchisees.³⁸ To qualify for disclosure in Item 3, Actions must either (i) involve allegations that the affected entity (whether the franchisor, its affiliate, parent or an individual listed in Item 2) has violated a franchise, antitrust, or securities law, or allege fraud, unfair or deceptive practices or comparable allegations; or (ii) are 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. The Item 3 disclosure obligations extend for a 10-year period before the issuance date of the FDD. The 10-year period is measured from the conclusion of a particular Action. The FTC Franchise Rule also requires that franchisors disclose franchisor-initiated Actions against franchisees (current and former) to enforce the terms of the franchise relationship, but limits this disclosure to only those Actions that have been filed within the franchisor's last fiscal year.³⁹ Actions falling into this category could include the enforcement of noncompete covenants, collection actions to require payment of amounts owed, and lawsuits to enforce system standards.

D. **Item 4 - Bankruptcy**

In Item 4, franchisors must disclose any bankruptcy or related proceedings that have occurred within the immediately preceding 10-year period.⁴⁰ Again, the measurement period should start from when a bankruptcy proceeding was concluded. This disclosure obligation extends to proceedings not just related to the franchisor, but also its parents, affiliates, predecessors and any individual identified in Item 2.

E. **Item 5 – Initial Fees**

Item 5 of the FDD requires the disclosure of any initial fees directly payable to the franchisor or its affiliates. "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."⁴¹ Typical fees to be included Item 5 are the initial franchise fee, any relevant multi-unit fee, initial training fees, pre-opening equipment purchases (if payable to franchisor or its affiliate), and grand opening advertising fees (again, only if those fees are payable to franchisor or its affiliates).

Item 5 must also disclose whether each fee listed is refundable (in whole or in part) under any circumstance. If any fee is payable in installments, those installments must be disclosed in Item 5.⁴² The total amount of fees in the aggregate that are disclosed in Item 5 must be included in the federal cover page of the FDD.

³⁸ 16 C.F.R. §436.5(c).

³⁹ *Id.*

⁴⁰ 16 C.F.R. §436.5(d).

⁴¹ 16 C.F.R. §436.5(e).

⁴² *Id.*

Item 5 disclosure requirements provide that if initial fees are not uniform for all franchisees, then the franchisor must either disclose the range of fees paid in the last year or disclose the formula used to calculate the initial fees paid in the last fiscal year, along with any factors other than the formula itself that determined the fee amount.⁴³

One common practice challenge with Item 5 is determining when a fee is payable. For example, if the franchisor charges franchisee a training fee, the determining factor is when that fee is payable. If it is payable prior to opening the franchise, then that fee must be disclosed in Item 5. If it is ongoing training that would occur after the franchise opens, it must be disclosed in Item 6 rather than Item 5. Another common challenge is knowing whether a fee is payable (in whole or in part) to the franchisor or an affiliate or to someone else. One prominent example of this challenge occurs when a franchisor provides a franchisee with the option to buy equipment for the franchise from the franchisor or a third-party supplier. Such an arrangement must be included in Item 5 because the franchisee *has an option* to purchase the equipment from the franchisor, even if it is more likely that the franchisee will purchase from a third-party supplier.

F. **Item 6 – Other Fees**

Item 6 of the FDD requires franchisors to disclose ongoing fees during the term of the franchise agreement, and only after the franchise business is open, that are payable to the franchisor or its affiliates.⁴⁴ Item 6 does not include amounts that are payable by the franchisee directly to third parties. Common fees included in Item 6 are royalties, advertising contributions, transfer fees, renewal fees, penalties on late payments and interest payments. Item 6 must be drafted in a tabular format prescribed by the FTC Franchise Rule.

Franchisors must disclose each type of fee, the amount of the fee, and the due date, as well as any formula used to compute the fee. If a fee has the potential to increase, franchisors must disclose the maximum amount of the increase or the formula used to determine the increase. Any remarks, definitions, caveats, or other information necessary to clarify the disclosed fees should be noted in the remarks column. However, franchisors may use footnotes instead of the remarks column if the remarks are too extensive. The remarks column (or footnote) must include, if applicable: (1) whether the fees are payable only to the franchisor, (2) whether the fees are imposed and collected by the franchisor, (3) whether the fees are non-refundable or the circumstances when the fees are refundable, (4) whether the fees are uniformly imposed, and (5) the voting power of franchisor-owned outlets on any fee imposed by cooperatives. Item 6 does not require franchisors to disclose whether fees charged in prior periods were different from the current periods; franchisors need only disclose whether the current fee is uniformly imposed and collected by the franchisor.

The most common fee that is mistakenly included in Item 6 is a required local advertising expenditure. Most franchise agreements require a franchisee to spend a certain amount on local advertising. This could be reflected as a percentage of gross revenue on franchisee's sales. While

⁴³ *Id.*

⁴⁴ 16 C.F.R. §436.5(f).

this is an ongoing expenditure during the term of the franchise agreement, these amounts are not payable to a franchisor or its affiliates and therefore should be excluded from Item 6.

G. Item 7 – Estimated Initial Investment

Item 7 requires the disclosure of the total initial investment necessary to build and open the franchised business, including amounts payable to third-parties.⁴⁵ Item 7 also estimates the operating funds necessary during the start-up phase of the franchised business, which typically includes the first three (3) months of operations. Similar to Item 6, Item 7 must be presented in the tabular format required by the FTC Franchise Rule. The table must clearly identify the type of expenditure, amount due or payable, method of payment, when the payment is due, and to whom the payment must be made.⁴⁶ Typical Item 7 expenditures include: (1) the initial franchise fee, (2) training expenses (such as franchisee's travel expenses and room and board), (3) equipment, (4) the cost to purchase or lease real property, (5) opening inventory, (6) business licenses and fees, and (7) a category for initial operating funds (typically 3 months).

The Item 7 table requires a dollar amount or range for each type of cost listed. A franchisor must list or explain where it derived the estimates contained in its Item 7. Typically, a franchisor will gather information from its franchisees regarding build-out costs that franchisees incurred. In many instances, franchisors will include an affirmative obligation in their franchise agreement to produce information and records related to build-out costs and construction of the franchised business. Item 7 should contain footnotes to explain any assumptions made by the franchisor, the variability of the costs disclosed, the methodology used to make any calculations, and any differences that may impact individual franchisees. The total investment at the bottom of Item 7 should equal the sum of the individual cost items included in the table, and the amounts listed as being paid to the franchisor should also match the disclosures in Items 5 and 6. The total investment amount disclosed in Item 7 should also be included in the federal cover page.

H. Item 8 – Restrictions on Sources of Products and Services

Item 8 can be one of the more complicated disclosure items in the FDD and is meant to disclose any restriction on franchisees with respect to the purchase or lease of products and services used in the franchised business.⁴⁷ Typically, franchisors will designate certain items that must be purchased from a specific set of suppliers (which may include franchisor or its affiliates) or products that must be purchased in accordance with franchisor's specifications. Common examples include goods, services, supplies, fixtures, equipment, computer hardware and software, inventory, real estate or any other item that may be proprietary to franchisor's operating system or standards. A franchisor must include all such items in Item 8, including a description of each item. Item 8 does not require franchisors to list items that franchisees may voluntarily purchase for the franchised business.

For any product that must be purchased only from a franchisor's approved supplier, the franchisor must include information on how the franchisor will evaluate and approve alternative

⁴⁵ 16 C.F.R. §436.5(g).

⁴⁶ *Id.*

⁴⁷ 16 C.F.R. §436.5(h).

suppliers.⁴⁸ A franchisor must also disclose how it will revoke such approval if it was previously granted. These disclosures must include whether the franchisor's criteria for approving alternative suppliers are available for franchisees to review, the fees that a franchisee must pay to have an alternative supplier evaluated, what procedures a franchisee must follow to get the franchisor to review an alternative supplier, and how long the review process will take. With respect to any product that must be purchased in accordance with franchisor's standards, franchisor must disclose whether it will permit franchisees or suppliers the ability to review such standards or written specifications, and if so, how.

A franchisor must also generally disclose its and its' and affiliates interests in any relationship it has with a supplier (i.e. rebates received from suppliers), or the purchases it requires from franchisees. Item 8 also provides a franchisee with information on the franchisor's financial interest in these sourcing restrictions by requiring the franchisor to disclose whether any of the franchisor's officers has an ownership interest in any of the approved suppliers and whether the franchisor or its affiliates will receive any revenues or other material consideration as a result of franchisees' purchases (including purchases from the franchisor, its affiliate or from approved suppliers).⁴⁹ Examples of these types of revenues and benefits are rebates, vendor contributions to the marketing fund, reduced prices for items the franchisor purchases for its company-owned units, etc.

If the franchisor or its affiliates will receive revenue or any other material consideration as a result of the sale of goods or services to franchisees, the franchisor must disclose how the revenues are received (i.e., flat payment, percentage of sales to franchisees, etc.) and how these revenues relate to the franchisor's or affiliate's total revenues; but does not have to disclose the specific name of the supplier that makes the payments.⁵⁰

Item 8 requires a disclosure of franchisee's required purchases in establishing, and then operating the franchise to its total purchase of required goods and services disclosed in Item 8. This disclosure is done by way of a percentage of total costs. Typically, this disclosure is satisfied by stating " the current required purchases in accordance with our standards and specifications and from approved or designated suppliers are approximately [x]% of the cost to establish the franchise business and approximately [x]% of the ongoing supplies cost of the franchised business."

This Item also provides information on any purchasing or distribution cooperatives that the franchisee may or must use, whether the franchisor will negotiate with suppliers for the franchisees' benefit, and whether the franchisor will "reward" franchisees that use certain suppliers, such as by offering renewal or additional franchises to cooperating franchisees.⁵¹

⁴⁸ *Id.*

⁴⁹ 16 C.F.R. §436.5(h)(8).

⁵⁰ 16 C.F.R. §436.5(h)(6).

⁵¹ 16 C.F.R. §436.5(h)(7),(9)-(11).

I. **Item 9 – Franchisee's Obligations**

Item 9 lists certain obligations of the franchisee pursuant to the underlying agreements to the franchise (i.e. franchise agreement and development agreement, if applicable).⁵² As with Item 6 and Item 7, this information must be captured in the tabular format mandated by the FTC Franchise Rule. The table lists the type of obligation, where that obligation can be found in the franchise agreement, and the corresponding Item in the FDD that discusses that obligation. Obligations contained in the Item 9 chart include site selection, pre-opening purchases, site development, initial and ongoing training, opening, fees, compliance with system standards, trademarks, restrictions on products and services, warranty and customer service requirements, territorial development and sales quotas, ongoing product/service purchases, maintenance, appearance and remodeling requirements, insurance, advertising, indemnification, owner's participation/management staffing, records and reports, inspections and audits, transfer, renewal, post-termination obligations, non-competition covenants and dispute resolution. A sample Item 9 chart is attached as Exhibit D.

J. **Item 10 – Financing**

If a franchisor provides direct or indirect financing to franchisees, or guarantees franchisee loans or leases, the franchisor must provide details in Item 10 related to each such arrangement.⁵³ Elements of required disclosures vary depending on the type of arrangement at hand, but generally include detail related to interest rates and finance charges, number of payments, penalties for default and, in the case of preferred lending arrangements, any consideration or benefit that a franchisor receives for referring prospective franchisees to a lender.

K. **Item 11 – Franchisor's Assistance, Advertising, Computer Systems and Training**

Item 11 is the lengthiest of the disclosure Items in the FDD. It covers several topics such as the franchisor's pre-opening and post-opening contractual obligations to the franchisee, the time it generally takes for a franchisee to open the franchise business, the marketing funds, cooperatives and other advertising that will impact the franchisee, the franchised business's computer system, the contents of the operations manuals, and the initial and ongoing training programs. When preparing the disclosures for this Item, it is easiest to break the topics down and treat each section on its own.

1. Franchisor's Obligations

The first section of disclosure relates to the franchisor's actual obligations to the franchisee under the franchise agreement and is broken down into pre-opening and post-opening obligations.⁵⁴ This section begins with a required statement that is provided in the FTC Franchise Rule and should only include mandatory obligations of franchisor under the franchise agreement.

⁵² 16 C.F.R. §436.5(i).

⁵³ 16 C.F.R. §436.5(j).

⁵⁴ 16 C.F.R. §436.5(k).

No discretionary or voluntary obligations of franchisor should be included in this list.⁵⁵ The obligations that may be included under pre-opening assistance typically include site selection assistance, negotiation of a lease or purchase agreement, site approval requirements, assistance in constructing and building-out the premises, assistance in hiring and/or training the franchisee's employees, and assistance in obtaining the necessary equipment, signs, fixtures, inventory and supplies to open the location. For each obligation, the disclosure must include a citation to the provision in the franchise agreement that states the obligation.

Post-opening obligations generally may include research and development of new products or services, administering the advertising fund, providing periodic assistance as advisable, permitting the ongoing use of confidential information, permitting the ongoing use of franchisor's trademarks, and ongoing advice concerning franchisee's general operations. Again, a citation must be included to the relevant provision in the franchise agreement.

2. Time to Open

Item 11 must disclose how long it typically takes to open a franchised business. Item 11 must also include any affirmative deadlines in the franchise agreement to open the franchised business, or any affirmative deadline to select a site or sign a lease. These deadlines may also include development and construction deadlines and well as pre-opening requirements. Item 11 must indicate what factors may affect this estimated time to develop and open the franchised business.

3. Advertising Programs

i. System-Wide Advertising Funds

Item 11 requires several disclosures concerning whether the franchisor or its designee administers a system-wide advertising fund that will advertise on behalf of its franchisees. These disclosures will describe how the marketing materials are prepared, what type of media is being used in the advertising materials, the production of the materials, who administers the fund, the amount franchisees are required to contribute to the fund, the amount company-owned locations are required to contribute to the fund and whether there is an advertising council composed of franchisees that franchisor solicits input from (there may be additional disclosures if there is).⁵⁶ This section of the FDD must also disclose whether franchisor will prepare audited financial statements of the system-wide fund, whether it will share those financials with franchisees, and how contributions to the system-wide fund were spent in franchisor's last fiscal year.

Franchisors should break these expenditures up into broad categories such as production, media, administrative, website and other. These percentages are based on amounts spent rather than amounts collected from the fund. If there is any amount left unspent from the prior fiscal year, the franchisor needs to disclose what will happen to those funds. Most often, the franchisor will carry those funds over for use in its next fiscal year. Additionally, this Item requires that franchisor disclose whether franchisor uses advertising funds to principally solicit franchisees.

⁵⁵ *Id.*

⁵⁶ 16 C.F.R. §436.5(k)(4).

ii. Local Advertising Expenditures and Advertising Cooperatives

Most franchisors require their franchisees to spend a minimum amount on local advertising within the franchisee's market. The FDD should also disclose whether the franchisee will be permitted to use its own marketing materials or whether those materials must be approved by franchisor prior to use. If the latter, the FDD should disclose how these materials are approved.

If there are local or regional marketing cooperatives in which a franchisee must participate, the franchisor must provide additional disclosures such as how the geographic coverage of cooperatives is determined, how much a franchisee must contribute to a cooperative and if this amount is the same for all franchisees and for franchisor owned units, who administers each cooperative, whether the cooperatives operate from written documents (such as by-laws), whether the cooperatives must prepare periodic financial statements, and whether the franchisor has the right to form, change or dissolve the cooperatives.

4. Computer Systems

Item 11 must disclose the relevant components of the franchisor's prescribed computer system or electronic cash register.⁵⁷ These disclosures focus on the basic functions of the computer system, including required purchases of both hardware and software.⁵⁸ All costs relating to the initial purchase or lease of the computer system should be listed in this disclosure and should match the initial investment figure contained in Item 7. This disclosure should also include the costs of ongoing maintenance, repairs, upgrades or updates and the contractual limitations on the cost or frequency of these upgrades or updates. If there is an annual cost for any optional or mandatory maintenance, updating, upgrading or support, the cost should be included in the disclosures.⁵⁹ Finally, the disclosures should indicate whether the franchisor will be able to independently access the franchisee's system to obtain data that the franchisee has created and stored in the system and whether there are any contractual limitations on the franchisor's access.

5. Operating Manuals

Item 11 requires certain disclosures regarding the franchisor's operating manual.⁶⁰ These can be made in two ways. First, and the most common method, is to disclose the franchisor's table of contents to the operating manual, along with a description of the number of pages devoted to each topic. This is typically done in an exhibit to the FDD.

The second option is to permit any prospective franchisee who requests to see the entire operating manual before signing the franchise agreement. Many franchisors that choose this method will require the prospective franchisee to sign a confidentiality agreement before allowing the prospective franchisee to view the operating manuals. In practice, it is better to disclose the table of contents rather than allow a prospective franchisee to review the entirety of the Operating

⁵⁷ 16 C.F.R. §436.5(k)(5).

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ 16 C.F.R. §436.5(k)(6).

Manual. Even with an NDA, allowing a prospective franchisee to review the operating manual exposes the franchisor to undue risk with respect to its proprietary information.

6. Training Programs

Item 11 requires a general description of franchisor's initial training program.⁶¹ The FTC Franchise Rule requires a specific table to be included on this subject, which includes the amount of time devoted to classroom and on-the-job training for each subject in the training program.⁶² This table also reveals where the training is to be held, whether on-site at the franchisee's business or at the franchisor's headquarters. Item 11 also requires franchisor to disclose how often the training is held, who conducts the training, the experience-level of who conducts the training, and the instructional materials provided during the training program. Many franchisors offer initial training materials remotely or online. Item 11 should disclose this. Item 11 should also disclose whether the franchisor charges any fees for the franchisee to attend the training program. These fees should match the relevant disclosure in Item 5. The disclosures also should indicate who must pay for the franchisee's travel and living expenses while attending the initial training program. The franchisor must disclose who is required to attend the initial training program, who is permitted but not required to attend, and whether the attendees must complete the training program to the franchisor's satisfaction.

Finally, this Item should include similar disclosures on any additional or refresher training programs that the franchisor requires the franchisee to attend. These disclosures should be broadly drafted to cover any potential training programs that may be created in the future.

L. **Item 12 – Territory**

Item 12 discloses the territorial protection (if any) associated with the franchised business.⁶³ Most franchisors reserve certain rights in any territory that is provided to the franchisee. For example, the franchisor will reserve rights in the territory to perform services under different trademarks, to acquire other businesses, to be acquired, the right to alternative channels of distribution, including the internet, and the right to conduct or franchise similar businesses in the territory. If the franchisor reserves any of these rights, then at the beginning of Item 12, the franchisor should list the following statement:

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.⁶⁴

If the franchisor grants franchisees a specific territory, it must explain what that entails, including whether the franchisor will be restricted from accepting customers in the restricted area, whether the franchisor may operate via alternative channels in the restricted area (i.e. the Internet),

⁶¹ 16 C.F.R. §436.5(k)(7).

⁶² *Id.*

⁶³ 16 C.F.R. §436.5(l).

⁶⁴ 16 C.F.R. §436.5(l)(5)(i).

any conditions the franchisee must meet to obtain the restricted area, whether franchisor reserves the right to operate in non-traditional locations (i.e. airports and train stations) in the restricted area and how franchisor determines the size and scope of the restricted area. The franchisor also must specify whether or not, and to what extent, a franchisee may solicit sales outside of its territory. If the franchisor or its affiliates franchise or operate businesses that will compete with franchisee in the territory, it must disclose those competing brands in Item 12 and list ways in which it will mediate disputes between franchisee and the competing brands. This disclosure item is often overlooked in the FDD. A practitioner should refer to the description of franchisor and its affiliates' business activities in Item 1 when determining whether it needs to disclose this information in Item 12.

A franchisor must also list the conditions that it will allow a franchisee to relocate the franchised business, any rights of first refusal, options to acquire additional franchises or similar rights franchisees will have.⁶⁵

M. **Item 13 – Trademarks**

Item 13 of the FDD requires disclosure of each principal trademark to be licensed to the franchisee.⁶⁶ Principal trademark means the primary trademarks, service marks, names, logos, and commercial symbols the franchisee will use to identify the franchised business. It is important to note that the franchisor is not required to include in Item 13 every trademark that the franchisor owns. Franchisors must disclose whether each of its principal trademarks is registered with the United States Patent and Trademark Office ("USPTO"), as well as application, renewal, and other related information. Franchisors generally disclose the registered marks in a chart showing the registration number and date and specifying whether the mark is registered on the principal or supplemental register of the USPTO.

If the franchisor has not secured a registration for its principal mark, Item 13 mandates the following prescribed statement: "We do not have a federal registration for our principal trademark. Therefore, our trademark does not have as 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."⁶⁷

Franchisors are also required to disclose the existence of any pending litigation, settlements, agreements, or superior rights that may limit a franchisee's use of the trademark, as well as any contractual obligation of the franchisor to protect a franchisee's right to use the principal trademarks, and to protect the franchisee against claims of infringement or unfair competition.

⁶⁵ 16 C.F.R. §436.5(l)(3)-(4).

⁶⁶ 16 C.F.R. §436.5(m).

⁶⁷ 16 C.F.R. §436.5(m)(4).

N. **Item 14 – Patents, Copyrights and Proprietary Information**

Item 14 discloses the franchisor's intellectual property, including patents, copyrights, and trade secrets.⁶⁸ If the franchisor maintains any patents or copyrights, it must disclose information relevant to those registrations, any pending or concluded legal proceedings, any settlement agreements, and any known infringing uses. Franchisors must describe in general terms the proprietary information communicated to the franchisee and the terms for use by the franchisee. Another key disclosure in Item 14 concerns the contractual obligations between franchisor and franchisee with respect to franchisor's confidential information. The franchisor should detail the rights it maintains concerning its confidential information and franchisee's limited use of such information.

O. **Item 15 - Obligation to Participate in the Actual Operation of the Franchise Business**

Item 15 concerns the management of the franchised business. Specifically, franchisors are required to disclose whether the franchisee must run the day-to-day operations of the business or may hire or appoint someone else to that role.⁶⁹ This disclosure is meant to inform the franchisee on how involved he or she must be in the franchised business. Many franchisees purchase the franchised business as a passive investment, and Item 15 should make clear whether that is possible under franchisor's business model. If a franchisee is permitted to hire a manager to run the business, it should disclose the requirements that apply to that manager, including whether the manager must have an ownership interest in the franchisee and whether the franchisor must approve the manager. Finally, Item 15 should disclose whether franchisee, its owners or any other individual (including a spouse) will be required to sign a personal guaranty in connection with the franchised business.

P. **Item 16 – Restrictions on What the Franchisee May Sell**

Item 16 discloses limitations on the franchisee's ability to sell products and services, including whether it must only sell those products and services approved and authorized by a franchisor. If a franchisee is permitted to add additional products and services, Item 16 will also disclose how the franchisee obtains approval from the franchisor to do so and whether the franchisor has the right to change the types of goods and services franchisees sell.⁷⁰

Q. **Item 17 – Renewal, Termination, Transfer and Dispute Resolution**

Item 17 is a summary of certain contractual provisions of the franchise agreement. As with Item 9, the FTC Franchise Rule prescribes that this information be presented in tabular format and in a certain order. The FTC Franchise Rule requires the following statement to appear in bold font preceding the Item 17 table: "**This table lists certain important provisions of the franchise and related agreements. You should read these provisions in the agreements attached to this**

⁶⁸ 16 C.F.R. §436.5(n).

⁶⁹ 16 C.F.R. §436.5(o).

⁷⁰ 16 C.F.R. §436.5(p).

disclosure document.⁷¹ The provisions of the franchise agreement that are summarized in Item 17 include transfer, renewal, termination and dispute resolution provisions. Item 17 should concisely summarize these provisions in the agreement, but still divulge enough information so that franchisees do not need to refer to the agreement to understand these rights under the franchise agreement.

R. **Item 18 – Public Figures**

Item 18 discloses any affiliation a franchisor maintains with a public figure (for example, a celebrity), including whether the public figure is involved in the ownership or management of the franchise system or whether the public figure receives compensation for its endorsement of the franchise. The key in determining whether a public figure needs to be disclosed in Item 18 is if that figure is used by the franchisor to offer and sell franchises. If not, then that figure does not need to be disclosed in Item 18. For example, a franchisor does not need to disclose a celebrity that invests in the franchise so long as that celebrity is not actively promoting the franchise opportunity.

S. **Item 19 – Financial Performance Representations**

Item 19 is a discretionary disclosure item concerning financial performance representations ("FPRs") with respect to franchised and company-owned units. In some ways, Item 19 is the most flexible disclosure item in the FDD because there is no rigid format to follow under the FTC Franchise Rule. In other ways, Item 19 is the most confounding disclosure item because it tends to be the most litigious. Many franchisors choose to omit disclosing any financial information in Item 19 because they may not have enough performance history to make reliable disclosures. The key to any Item 19 disclosure is that whatever information the franchisor uses, the franchisor must have a "reasonable basis" to do so. The only way a franchisor can share revenue information with a prospective franchisee during the sales process is through information that appears in Item 19. Without an FPR in Item 19 of the FDD, a franchisor cannot present any FPR information to a prospect. Franchisors also must be careful that whatever FPR is made by its representatives to a prospect be limited only to the information contained in Item 19.

One reason Item 19 is more flexible than other items under the FTC Franchise Rule is that all franchise systems have different ways beyond just "earnings" to assess financial health of the business (for example, gyms may use membership rates while hotels may use room occupancy rates). In fact, Section 436.1(e) of the FTC Franchise Rule defines a "financial performance representation" broadly:

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.

⁷¹ 16 C.F.R. §436.5(q).

Any Item 19 must start with the following language:

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 location or under particular circumstances.⁷²

If a franchisor declines to make any FPRs in its Item 19, the Item 19 must immediately state the following:

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 authorities.⁷³

As noted above, any information contained in Item 19 must have a "reasonable basis" for the representation at the time it is made. This offers a franchisor wide latitude in what information it should include in its Item 19. On May 8, 2017, NASAA released commentary on Item 19, which further defined and offered guidance on how to make certain disclosures (the "FPR Commentary"). The FPR Commentary, for example, regulated the types of disclaimers that franchisors can use in Item 19 and states that a franchisor's use of company-owned outlets alone in Item 19 is not reasonable if a franchisor has franchised outlets and requires that a franchisor to disclose results from the franchised outlets.

Financial performance representations can be based on historical information or projections of future performance, though it is safer and much more common to disclose based on historical projections. In practice, franchisors should rarely, if ever, use future performance projections because they are likely to be less reliable and expose the franchisor to potential claims of misrepresentation and fraud (especially if those projections do not turn out as expected).

⁷²16 C.F.R. §436.5(s)(1).

⁷³ 16 C.F.R. §436.5(s)(2).

Franchisors must clearly delineate the source of the underlying data used in Item 19, such that a prospective franchisee views the Item 19 statement with the full context in which it is framed. For example, Item 19 should clearly identify what group of franchisees or company-owned outlets are included in the data. Franchisors are permitted to exclude certain outlets so long as there is a reasonable basis to do so. Two common examples are excluding outlets that may be open seasonally (i.e., an ice cream shop that is open in the summer months) or excluding outlets that have not been open for a full twelve (12) months. Franchisor must make these exclusions clear within the body of Item 19.

As noted above, the FPR Commentary changed Item 19 disclosures by offering more guidance on how FPRs should be made to prospects. For example, many FPRs show gross revenue figures earned by outlets. The FPR Commentary made clear that when disclosing gross revenue figures, a franchisor must also list the average (mean) gross revenue, the median, and the highest and lowest numbers in the range. The FTC Rule also requires franchisors to disclose what percentage of the outlets in the data set met or exceeded the performance shown by the gross revenue figures.⁷⁴ This ensures that prospective franchisees easily can identify whether the stated performance level (average gross revenue, for example) was achieved by a majority of the franchised outlets or whether one or two high volume locations skewed the average.

Franchisors are required to include an "admonition" in Item 19 that warns prospective franchisees that their performance may differ from the stated level. However, the FPR Commentary made clear that Item 19 may not be littered with numerous other disclaimers that negate a prospective franchisee's ability to rely on the information presented. Specifically, the FPR Commentary requires that a franchisor only use the following:

- For historical representations – "Some [outlets] have [sold] [earned] this amount. Your individual results may differ. There is no assurance that you'll [sell] [earn] as much."
- For projections – "These figures are only estimates of what we think you may [sell] [earn]. Your individual results may differ. There is no assurance that you'll [sell] [earn] as much."

Finally, franchisors that make financial performance representations in Item 19 must provide written substantiation of the statement to prospective franchisees upon reasonable request, the precise determination of which is to be made based on all surrounding facts and circumstances associated with the request.

T. Item 20 – Outlets and Franchisee Information

Item 20 discloses unit counts for both franchisee-owned and company-owned outlets. Drafters are prone to make mistakes when drafting Item 20.⁷⁵ In general, this Item contains five tables with certain prescribed information. The tables are designed to disclose where outlets in the system are located (and have been for the last three years) and where the franchisor anticipates new outlets

⁷⁴ 16 C.F.R. §436.5(s)(3)(ii)(D)

⁷⁵ 16 C.F.R. §436.5(t).

to be located within the next year. The tables also inform a prospective franchisee of the overall health of the franchise.

1. Table 1 – Systemwide Outlet Summary

Table 1 is a general summary of overall unit counts for both franchisee-owned and company-owned outlets. The following is an example of Table 1:

TABLE NO. 1
SYSTEMWIDE OUTLET SUMMARY FOR YEARS 2018-2020

OUTLET TYPE	YEAR	OUTLETS AT THE START OF THE YEAR	OUTLETS AT THE END OF THE YEAR	NET CHANGE
Franchised	2018	2	2	0
	2019	2	4	+2
	2020	4	3	-1
Company Owned	2018	1	2	+1
	2019	2	2	0
	2020	2	3	+1
Total Outlets	2018	3	4	+1
	2019	4	6	+2
	2020	6	6	0

2. Table 2 – Transfers of Outlets

Table 2 of Item 20 should list the total number of transfers that occurred between owners during the franchisor's prior fiscal year, including the transfers in each state. The following is an example of Table 2:

STATE	YEAR	NUMBER OF TRANSFERS
Arizona	2018	1
	2019	2
	2020	0
TOTAL	2018	1
	2019	2
	2020	0

3. Table No. 3 – Status Of Franchised Outlets

Table 3 shows the last three fiscal years of franchisee activity. It must show the outlets at the start of the year, the number of outlets terminated, the number of non-renewals, the number of outlets required by franchisor, the number of outlets that ceased operations for any other reason, and the total number of outlets at the end of the fiscal year. The following is an example of Table 3:

STATE	YEAR	OUTLETS AT START OF YEAR	OUTLETS OPENED	TERMINATIONS	NON-RENEWALS	REACQUIRED BY FRANCHISOR	CEASED OPERATIONS- OTHER REASONS	OUTLETS AT END OF YEAR
Arizona	2018	0	1	0	0	0	0	1
	2019	1	0	0	0	0	0	1
	2020	1	0	0	0	0	0	1
Florida	2018	0	0	0	0	0	0	0
	2019	0	1	0	0	0	0	1
	2020	1	2	0	0	0	0	3
Missouri	2018	0	0	0	0	0	0	0
	2019	0	1	0	0	0	0	1
	2020	1	0	1	0	0	0	0
Nevada	2018	2	0	0	0	1	0	1
	2019	1	0	0	0	0	0	1
	2020	1	0	0	0	0	0	1
Total	2018	2	1	0	0	1	0	2
	2019	2	2	0	0	0	0	4
	2020	4	2	1	0	0	0	5

4. Table 4 – Status of Company-Owned Outlets

Table 4 shows the activity of company-owned outlets during the last three fiscal years. It must show the same information as Table 3: outlets at the start of the year, the number of outlets terminated, the number of non-renewals, the number of outlets required by franchisor, the number of outlets that ceased operations for any other reason, and the total number of outlets at the end of the fiscal year. The following is an example of Table 4:

State	Year	Outlets at Start of Year	Outlets Opened	Outlets Reacquired From Franchisees	Outlets Closed	Outlets Sold to Franchisees	Outlets at end of the Year
Nevada	2018	1	1	1	0	0	2
	2019	2	0	0	0	0	2
	2020	2	1	0	0	0	3
Total	2018	1	1	1	0	0	2
	2019	2	0	0	0	0	2
	2020	2	1	0	0	0	3

5. Table No. 5 – Projected Openings As Of Last Fiscal Year End

Table 5 is the number of projected openings, both franchisee-owned and company-owned, during the franchisor's upcoming fiscal year. Table 5 also shows the Franchise Agreements that are signed but the outlet is not yet opened. The following is an example of Table 5:

State	Franchise Agreements Signed but Outlet Not Opened	Projected New Franchised Outlets in the Next Fiscal Year	Projected New Company-Owned Outlets in the Next Fiscal Year
Alabama	0	0	0
California	1	1	0
Colorado	1	1	0
Florida	2	2	0
Utah	0	0	0
Washington	0	1	0
TOTAL	4	5	0

Item 20 requires a list of current franchisees, including names, addresses and phone numbers for each outlet. This list of current franchisees should also indicate franchisees who have signed a franchise agreement but have not yet opened their outlet. This should be separate and apart from the list of current franchisees who are operating an outlet and who are included in Table 3 of Item 20.

Item 20 also requires a list of franchisees, including name, city and state, current business telephone number, or if unknown the last known home telephone number for every franchisee of an outlet that was transferred or closed within the past fiscal year.⁷⁶ This list also should include franchisees who have not communicated with the franchisor within 10 weeks of the FDD issuance date.

Item 20 also requires a few miscellaneous disclosures. First, franchisors are required to disclose whether any former franchisees have signed confidentiality agreements that would restrict their ability to speak about a franchisor and a franchised business. Item 20 also requires a disclosure regarding whether there are any trademark-specific franchisee organizations associated with the franchise system (such as a franchisor-sponsored group, leadership council, or independent franchisee association). In order to be included in Item 20 of an FDD, an independent franchisee association must be incorporated or organized under state law and must submit a written request to a franchisor to be included within 60 days after the end of the franchisor's fiscal year.

U. Item 21 – Financial Statements

Item 21 requires inclusion of a franchisors' financial statements (audited in accordance with GAAP) for the past three fiscal years.⁷⁷ Generally, a franchisor must include the following financial statements: (i) a balance sheet as of the end of the two most recent fiscal years; (ii) a statement of operations for the three most recent fiscal years; (iii) a statement of owners' equity for the three most recent fiscal years; and (iv) a statement of cash flows for the three most recent fiscal years. The financial statements should be organized in tabular format for that compare at least two fiscal years, which allows prospective franchisees to view the necessary information to assess financial trends in a franchise system.

⁷⁶ 16 C.F.R. §436.5(t)(4) and (5).

⁷⁷ 16 C.F.R. §436.5(u).

A parent entity's financial statements must be included if the parent performs post-sale obligations for the franchisor or guarantees the obligations of the franchisor. Similarly, an affiliate's financial statements may take the place of the franchisor's if the affiliate guarantees the franchisor's performance. A franchisor must include a copy of the guarantee in the attachments to the FDD. Certain registration states may require their own form of parent/affiliate guarantee.

A start-up franchise system is allowed to "phase-in" the use of audited financial statements over the course of three years. However, certain franchise registration states have not incorporated the phase-in into their statutes and will not register an FDD without audited financials. It is important to note that the phase-in applies only to companies that are new to franchising and that do not yet have audited financial statements.⁷⁸

If a franchisor qualifies for the phase-in, it initially may provide an unaudited opening balance sheet, which should be formatted similarly to an audited balance sheet. For the franchisor's second year, it must include an audited balance sheet opinion on its financial condition based on its opening balance sheet and balance sheet prepared at the end of the first fiscal year. In the FDD that is used during the third and subsequent fiscal years of selling franchises, the franchisor must include all required audited financial statements required by the FTC Franchise Rule. The FTC Franchise Rule requires new franchisors to prepare audited financial statements as soon as practical, and mandates that unaudited financial statements must be in a form that conforms as closely as possible to audited statements. If the franchisor has not been in operation for three or more years, then it must clearly note this in Item 21 and state that it cannot include all the financial statements required by the FTC Franchise Rule.

V. **Item 22 – Contracts**

Item 22 requires a list of all the underlying and proposed agreement of the franchise offering, including the franchise agreement, multi-unit agreement, and any required release agreement. These agreements all must be attached as exhibits and are part of the FDD.⁷⁹

W. **Item 23 – Receipts and State Effective Date**

As noted above, NASAA now requires that the state effective dates page appear before Item 23 receipts. Item 23 notes that receipt pages are to be the last pages of the FDD. The receipt pages serve a few functions. First and most importantly, it evidences the date that franchisee received the FDD and leaves no doubt whether the franchisor complied with the timing requirements as discussed in Section V.A below. Second, the receipt pages contain certain information regarding federal and state law. Finally, the receipt pages identify all "franchise sellers involved in the offer and sale of the franchise. A practical tip: leave at least one blank for a franchise seller to fill-in on a form receipt page. That way, the franchisor does not have to amend the receipt pages throughout the year.

⁷⁸ The phase-in is not available to spin-offs, affiliates, or subsidiaries of existing franchisors that have prepared audited financial statements in the past.

⁷⁹ 16 C.F.R. §436.5(v).

V. **Disclosure Procedures**

A. **Timing**

As previously mentioned, the FTC Franchise Rule requires that a prospective franchisee be disclosed with franchisor FDD at least 14 calendar days before signing the franchise agreement or paying any compensation to the franchisor (including a deposit).⁸⁰ The wait period is misleading because the day the FDD is delivered and the day the prospect signs do not count when calculating the 14 days. Thus, this should really be considered 16 days. The FTC Franchise Rule also requires that if the franchisor unilaterally and materially alters the terms of the franchise agreement or any other agreement that is included as an exhibit in the FDD, the franchisor must provide the revised agreement to the prospective franchisee and then wait seven calendar days before the prospective franchisee signs the agreement. Negotiated changes between the franchisor and the prospective franchisee do not trigger this additional seven day wait period. In practice, it is unusual for this to come up as most changes to an agreement in an FDD would be negotiated between the parties.

Some states have different timing requirements than those set forth under the FTC Franchise Rule. Currently, the states that impose additional timing requirements include: Iowa (earlier of first personal meeting or 14 days in order to meet the requirements for an exemption from the business opportunity law), Michigan (10 business days), New York (earlier of first personal meeting or 10 business days), Oklahoma (earlier of first personal meeting or 10 business days in order to meet the requirements for an exemption from the business opportunity law), Rhode Island (earlier of first personal meeting or 10 business days), and Washington (10 business days). Be sure to follow whichever law has a longer wait period between the FTC Franchise Rule or the relevant state waiting period.

B. **Method of Delivery and Proof of Compliance**

The FDD may be delivered to the prospective franchisee in many ways, including by hand, email or other form of electronic delivery such as DocuSign or Adobe Sign. Prior to delivery of the FDD, the franchisor must inform the prospective franchisee of the available formats for the FDD, the prerequisites for obtaining the FDD in each available format and the conditions to viewing the FDD. One issue that arises when delivering the FDD electronically is that it must be delivered in a way that would allow the prospective franchisee to keep the FDD for later use (i.e. downloading it). The FDD must also be in one single document and cannot be provided in multiple parts. A franchisor, for example, cannot provide a separate Item 23 receipt page for execution purposes to return to a franchisor. The receipts must be included with the entire FDD in one file.

Upon receipt of the FDD, the prospective franchisee is required to sign and date an Item 23 Receipt, which serves as presumptive evidence of the date of delivery of the FDD. Franchisors are required by federal law to keep copies of FDD receipts for a period of three years, and state franchise laws also require document retention. California, for example, requires a franchisor to maintain receipts in perpetuity.

⁸⁰ 16 C.F.R. §436.2(a).

C. Who to Disclose

A franchisor must provide its FDD to each "prospective franchisee." A prospective franchisee is defined as "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."⁸¹ An agent or representative would include, for example, the franchisee's attorney. If the prospective franchisee is an entity, the franchisor may disclose the franchisee's officers, members or partners or other designated representative. In certain instances, it may not be clear who the ultimate franchisee will be when disclosing a potential buyer with the FDD. In these instances, it is better to over-disclose individuals with the the FDD than to under-disclose. In that regard, it is important to ensure the FDD is provided to any individual signing or guaranteeing a franchise agreement, and if the franchisee is an entity, any individual owner or guarantor of the franchisee entity.

D. Required Amendments to the FDD

The FTC Franchise Rule requires the following: (1) an annual update of the FDD, which is required within 120 days of the franchisor fiscal year-end; and (2) a quarterly update detailing any material changes to the FDD, which must be submitted within a reasonable time after the close of each quarter of the fiscal year. While the annual update requires an FDD with an entirely new issuance date under the FTC Franchise Rule, the quarterly update only requires an attachment to the existing FDD to reflect any material changes.

The FTC Franchise Rule does not define which qualities distinguish a material change from a non-material change, but a working definition of a material change includes any change that would reasonably be expected to influence a prospective franchisee's purchasing decision or have a significant negative effect on the financial condition of the franchise system. For example, a CEO leaving a company would be considered a material change. Further, if several franchisees left the system in a short time period, that would be considered a material change. Finally, and perhaps most commonly, if the franchisor is sued, that would be considered a material change and require an amendment to the FDD. Please note, this requirement is not triggered if the franchisor initiates the litigation in question. If the material change affects previously audited financial information, the franchisor is not required to re-audit the information for the quarterly update, however the franchisor must append unaudited financial statements.

With respect to the annual FDD update, it is important to note who must be re-disclosed with the revised FDD. As a rule of thumb, once the annual update to the FDD has been completed, any prior version of the FDD may not be used in any manner, including for the disclosure of any prospects in any state moving forward. Further, if any prospect was previously disclosed during the update process, but prior to the completion of the annual update, then best practices dictate that these prospects should be re-disclosed with the final version of the updated FDD, following the mandatory waiting periods described below (though this is not explicitly required under the FTC Franchise Rule unless the candidate requests to be re-disclosed).

⁸¹ 16 C.F.R. §436.1(r).

The FTC Franchise Rule's quarterly updating requirement described above is less stringent than the immediate update requirement mandated by all the states that have enacted their own franchise disclosure laws. Though the exact wording differs on a state-by-state basis, these laws generally stipulate that a franchisor must cease selling franchises whenever a material change to the system occurs, until the FDD has been updated to reflect that change. What may constitute a "material change" in the state context is often set forth in the statute or regulations. In addition to changes that would be considered material by the federal standard, arguably less substantively significant alterations, such as a change of the franchisor's address, may also require immediate disclosure.

VI. **Exemptions**

A. **Federal Exemptions**

The FTC Rule and certain states provide certain exemptions from disclosure and/or registration requirements in connection with the FDD. If the transaction qualifies for an exemption under the FTC Franchise Rule, the franchisor is not required to comply with the pre-sale disclosure requirements of the FTC Franchise Rule (i.e. no FDD is required). Below is an analysis of a few of the more common federal exemptions.

1. Minimal Franchise Fee

Should a franchisee be required to pay franchisor (or any of its affiliates) \$615⁸² or less during the first six months of commencing operations, then the franchise sale is exempt from the disclosure requirements of the FTC Franchise Rule. The FTC Rule defines "required payment" as "all consideration that the franchisee must pay to the franchisor or an affiliate, either by contract or by practical necessity, as a condition of obtaining or commencing operation of the franchise. A required payment does not include payments for the purchase of reasonable amounts of inventory at bona fide wholesale prices for resale or lease."⁸³ This exemption is useful for franchisors that are willing to defer the payment of fees for a period of six months to avoid the expense of preparing a FDD.⁸⁴ One way to structure a franchise program to take advantage of this exemption is to have the franchisee sign a non-negotiable promissory note that is due after the expiration of the six-month period.

2. Fractional Franchise Exemption

A franchisee qualifies for the "fractional franchise" exemption if: (1) the franchisee, any of its current directors or officers, or any current directors or officers of a parent or affiliate, has more than two (2) years of experience in the same type of business, and (2) the parties to the transaction

⁸² 16 C.F.R. §436.8(a)(1). The Commission is required to adjust the threshold for the minimum payment exemption every four (4) years to account for inflation.

⁸³ 16 C.F.R. § 436.1(s),

⁸⁴ See, David B. Ramsey, Adam Siegelheim and Leonard Vines, *Exemption Based Franchising for Established and Start-Up Franchisors*, 50th Annual Legal Symposium (2017).

have a reasonable basis to believe that the sales arising from the relationship will not exceed 20% of the franchisee's total dollar volume in sales during the first year of operation.⁸⁵

Under the FTC Franchise Rule, "same type of business" means selling competitive goods, or being in a business that would ordinarily be expected to sell the type of goods to be offered by the franchised business.⁸⁶ Typically, the second prong is achieved by measuring sales from multiple locations operated by the franchisee. For example, the parties may compare sales resulting from the fractional franchise against total sales at all stores owned by the franchisee (franchised or non-franchised).

3. Insider Exemption

The "Insider Exemption" is available when one or more purchasers of at least 50% ownership in the subject franchise within 60 days of the sale has been, for at least two years, an officer, director, general partner or individual with management responsibility for the franchisor's franchise sales program or the administration of its network, or in the alternative, when one or more of such purchasers has been an owner of at least 25% of the franchisor.

4. Large Franchisee Exemption

The Large Franchisee exemption applies to franchisees (or its parent or any affiliates) that have been in business for at least five years and has a net worth of at least \$6,165,500.⁸⁷ There is no requirement that the five years of prior experience be in franchising or a similar line of business. As alluded to above, when determining the prior experience and net worth of a franchisee entity, a franchisor may consider the prior experience and net worth of the prospective franchisee's affiliates and parents, which may be greater than that of the franchisee entity.

5. Large Franchise Investment

The "Large Franchise Investment" exemption applies when the franchisee's initial investment, excluding any financing received from the franchisor or an affiliate, and excluding the cost of unimproved land, totals at least \$1,233,000.^{88, 89} The prospective franchisee must also sign an acknowledgment verifying the grounds for the exemption. The acknowledgement must contain the following statement:

The franchise sale is more than \$1,233,000 – 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).

⁸⁵ *Id.* at 14.

⁸⁶ Compliance Guide, *supra* note 15 at 8.

⁸⁷ 16 C.F.R. § 436.8(a)(5)(ii). As with the minimum franchise fee exemption, the Commission adjusted the minimum net worth requirement to \$6,165,500, effective July 1, 2020.

⁸⁸ 16 C.F.R. § 436.8(a)(5)(i). The Commission adjusted the large investment threshold to reflect \$1,143,100, effective July 1, 2016.

⁸⁹ Please note, each state's large investment rules are different from the FTC Franchise Rule.

The amount listed in Item 7 determines the range of an initial investment to be measured for this exemption. It is important to note that if the franchisee has multiple owners or investors, at least one of those owners and investors must invest the required level for the exemption to apply.

6. Other Federal Exemptions

In addition to the federal exemptions outlined above, the FTC Franchise Rule recognizes other exemptions that are less commonly used: (1) leased department, (2) franchise relationships covered by the Petroleum Marketing Practice Act, or (3) where there exists no written document that describes any material term or aspect of the relationship or arrangement.

B. State Exemptions and Exclusions

If all elements of a federal exemption are satisfied under the FTC Franchise Rule as noted above, a franchisor must still ensure that it satisfies any state exemption or state exclusion⁹⁰ that is applicable to that transaction. Not all federal exemptions are available at the state level and often the exemption requirements differ. It is important to note that the scope of many state exemptions apply only to whether a franchisor must register with that state prior to selling. A franchisor may still be required to disclose a prospect with an FDD, even if that FDD is not required to be registered prior to selling the franchise. Therefore, in practice, a practitioner must first understand whether a transaction is exempt from only registration requirements, or both registration and disclosure requirements.

VI. Additional Filing Requirements Beyond the FDD

A. Advertising Registration Requirements

Certain states require the filing of franchise sales advertising materials before they may be used, including California, Maryland, Minnesota, New York, North Dakota and Washington.⁹¹ Each state's registration requirements differ, but generally an advertisement is deemed approved if you do not hear back within a certain number of days.⁹² Most internet-based franchise offers and sales are exempt from these registration requirements so long as (1) the advertisement states that the offer is not directed to residents of the state, (2) the advertisement is not actually directed to any resident of the state, and (3) no franchises are sold in the state until the franchisor obtains state registration.⁹³ With respect to a website that advertises sales of a franchise, that website must state:

This website and the franchise sales information on this site do not constitute an offer to sell a franchise. The offer of a franchise can only be made through the delivery of a

⁹⁰ Exemptions apply to relationships that constitute a 'franchise' but are exempt from a state's franchise laws. Exclusions are relationships that do not constitute a 'franchise' under the relevant state franchise law, and therefore, the regulation does not apply.

⁹¹ See, Janaki Parmar and John Moore, *Basics Track: Registration & Disclosure*, 51st Annual Legal Symposium (2018) at 39.

⁹² *Id.*

⁹³ *Id.*

franchise disclosure document. Certain states require that we register the franchise disclosure document in those states. The communications on this website are not directed by us to the residents of any of those states. Moreover, we will not offer or sell franchises in those states until we have registered the franchise (or obtained an applicable exemption from registration) and delivered the franchise disclosure document to the prospective franchisee in compliance with applicable law.

B. Franchise Seller / Broker Requirements

Some states⁹⁴ also require that franchise sellers/brokers fill-out a franchise seller disclosure form in connection with the FDD registration process. The FTC Franchise Rule defines a "franchise seller" as a person that offers, sells or arranges for the sale of a franchise.⁹⁵ This would include the franchisor and its employees, agents, area representatives, subfranchisors and third-party brokers, but does not include existing franchisees.⁹⁶ In some states, most notably Washington, a third-party sales broker must be registered in that state prior to engaging in any sales activities in that state.

VI. Conclusion

This paper merely provides a general overview of federal and state regulations on franchising. This is a complicated and evolving topic, difficult to summarize in a single paper. Violators of these regulations can face serious consequences from the FTC, various state agencies and franchisees. It is important to advise clients thoroughly and conservatively when drafting an FDD and formulating a standard disclosure and sales process.

⁹⁴ These states include California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island and Washington.

⁹⁵ 16 C.F.R. §436.1(j).

⁹⁶ See, Janaki Parmar and John Moore, *Basics Track: Registration & Disclosure*, 51st Annual Legal Symposium (2018) at 40.

EXHIBIT A

EXAMPLE FEDERAL COVER PAGE

The following is an example of a required federal cover page:

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. 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. **Note, however, that no governmental agency has verified the information contained in this document.**

You may wish to receive your disclosure document in another format that is more convenient to you. To discuss the availability of disclosures in different formats, contact [name or office] at [address] and [telephone number].

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. 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.

There may also be laws on franchising in your state. Ask your state agencies about them.

[Insert Issuance Date]

EXHIBIT B

EXAMPLE STATE COVER PAGE

The following is an example of a state cover page in its new format:

How to Use This Franchise Disclosure Document

Here are some questions you may be asking about buying a franchise and tips on how to find more information:

QUESTION	WHERE TO FIND INFORMATION
How much can I earn?	Item 19 may give you information about outlet sales, costs, profits or losses. You should also try to obtain this information from others, like current and former franchisees. You can find their names and contact information in Item 20 or Exhibit [].
How much will I need to invest?	Items 5 and 6 list fees you will be paying to the franchisor or at the franchisor's direction. Item 7 lists the initial investment to open. Item 8 describes the suppliers you must use.
Does the franchisor have the financial ability to provide support to my business?	Item 21 or Exhibit [] includes financial statements. Review these statements carefully.
Is the franchise system stable, growing, or shrinking?	Item 20 summarizes the recent history of the number of company-owned and franchised outlets.
Will my business be the only [XYZ] business in my area?	Item 12 and the "territory" provisions in the franchise agreement describe whether the franchisor and other franchisees can compete with you.
Does the franchisor have a troubled legal history?	Items 3 and 4 tell you whether the franchisor or its management have been involved in material litigation or bankruptcy proceedings.
What's it like to be [an XYZ] franchisee?	Item 20 or Exhibit [] lists current and former franchisees. You can contact them to ask about their experiences.
What else should I know?	These questions are only a few things you should look for. Review all 23 Items

	and all Exhibits in this disclosure document to better understand this franchise opportunity. See the table of contents.
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What You Need To Know About Franchising *Generally*

Continuing responsibility to pay fees. You may have to pay royalties and other fees even if you are losing money.

Business model can change. The franchise agreement may allow the franchisor to change its manuals and business model without your consent. These changes may require you to make additional investments in your franchise business or may harm your franchise business.

Supplier restrictions. You may have to buy or lease items from the franchisor or a limited group of suppliers the franchisor designates. These items may be more expensive than similar items you could buy on your own.

Operating restrictions. The franchise agreement may prohibit you from operating a similar business during the term of the franchise. There are usually other restrictions. Some examples may include controlling your location, your access to customers, what you sell, how you market, and your hours of operation.

Competition from franchisor. Even if the franchise agreement grants you a territory, the franchisor may have the right to compete with you in your territory.

Renewal. Your franchise agreement may not permit you to renew. Even if it does, you may have to sign a new agreement with different terms and conditions in order to continue to operate your franchise business.

When your franchise ends. The franchise agreement may prohibit you from operating a similar business after your franchise ends even if you still have obligations to your landlord or other creditors.

Some States Require Registration

Your state may have a franchise law, or other law, that requires franchisors to register before offering or selling franchises in the state. Registration does not mean that the state recommends the franchise or has verified the information in this document. To find out if your state has a registration requirement, or to contact your state, use the agency information in Exhibit [].

Your state also may have laws that require special disclosures or amendments be made to your franchise agreement. If so, you should check the State Specific Addenda. See the Table of Contents for the location of the State Specific Addenda.

Special Risks to Consider About *This* Franchise

Certain states require that the following risk(s) be highlighted:

1. **Out-of-State Dispute Resolution.** The franchise agreement requires you to resolve disputes with the franchisor by mediation, arbitration and/or litigation only in [State]. Out-of-state mediation, arbitration, or litigation may force you to accept a less favorable settlement for disputes. It may also cost more to mediate, arbitrate, or litigate with the franchisor in [State] than in your own state.

Certain states may require other risks to be highlighted. Check the "State Specific Addenda" (if any) to see whether your state requires other risks to be highlighted.

EXHIBIT C

EXAMPLE TABLE OF CONTENTS

ITEM 1 THE FRANCHISOR AND ANY PARENTS, PREDECESSORS AND AFFILIATES.....Error! Bookmark not defined.

ITEM 2 BUSINESS EXPERIENCEError! Bookmark not defined.

ITEM 3 LITIGATIONError! Bookmark not defined.

ITEM 4 BANKRUPTCY.....Error! Bookmark not defined.

ITEM 5 INITIAL FEESError! Bookmark not defined.

ITEM 6 OTHER FEESError! Bookmark not defined.

ITEM 7 ESTIMATED INITIAL INVESTMENT YOUR ESTIMATED INITIAL INVESTMENT.....Error! Bookmark not defined.

ITEM 8 RESTRICTIONS ON SOURCES OF PRODUCTS AND SERVICESError! Bookmark not defined.

ITEM 9 FRANCHISEE'S OBLIGATIONS.....Error! Bookmark not defined.

ITEM 10 FINANCING.....Error! Bookmark not defined.

ITEM 11 FRANCHISOR'S ASSISTANCE, ADVERTISING, COMPUTER SYSTEMS AND TRAINING.....Error! Bookmark not defined.

ITEM 12 TERRITORY.....Error! Bookmark not defined.

ITEM 13 TRADEMARKS.....Error! Bookmark not defined.

ITEM 14 PATENTS, COPYRIGHTS AND PROPRIETARY INFORMATION.....Error! Bookmark not defined.

ITEM 15 OBLIGATION TO PARTICIPATE IN THE ACTUAL OPERATION OF THE FRANCHISE BUSINESSError! Bookmark not defined.

ITEM 16 RESTRICTIONS ON WHAT THE FRANCHISEE MAY SELL .Error! Bookmark not defined.

ITEM 17 RENEWAL, TERMINATION, TRANSFER AND DISPUTE RESOLUTION THE FRANCHISE RELATIONSHIPError! Bookmark not defined.

ITEM 18 PUBLIC FIGURESError! Bookmark not defined.

ITEM 19 FINANCIAL PERFORMANCE REPRESENTATIONSError! Bookmark not defined.

ITEM 20 OUTLETS AND FRANCHISEE INFORMATIONError! Bookmark not defined.

ITEM 21 FINANCIAL STATEMENTS.....Error! Bookmark not defined.

ITEM 22 CONTRACTS.....Error! Bookmark not defined.

ITEM 23 RECEIPTError! Bookmark not defined.

Exhibits to Franchise Disclosure Document

- Exhibit A - List of State Administrators/Agents for Service of Process
- Exhibit B - Franchise Agreement
- Exhibit C - Development Rights Rider to the Franchise Agreement
- Exhibit D - State Addenda
- Exhibit E - Financial Statements
- Exhibit F - Table of Contents - Confidential Operations Manual
- Exhibit G - List of Franchisees
- Exhibit H - Form Consent to Transfer
- Exhibit I - Form General Release Agreement

EXHIBIT D

EXAMPLE TABLE 9

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 Franchise Agreement	Item in Disclosure Document
a. Site selection and acquisition/lease		Items 6 and 11
b. Pre-opening purchases/leases		Items 7 and 8
c. Site development and other pre-opening requirements		Items 6, 7 and 11
d. Initial and ongoing training		Items 6, 7 and 11
e. Opening		Item 11
f. Fees		Items 5, 6 and 7
g. Compliance with standards and policies/Operating Manual		Items 8 and 11
h. Trademarks and proprietary information		Items 13 and 14
i. Restrictions on products/services offered		Items 8 and 16
j. Warranty and customer service requirements		Item 11
k. Territorial development and sales quotas		Item 12
l. Ongoing product/service purchases		Item 8
m. Maintenance, appearance and remodeling requirements		Items 6 and 11
n. Insurance		Items 6, 7 and 8
o. Advertising		Items 6, 7 and 11
p. Indemnification		Item 6
q. Owner's participation/management/staffing		Items 11 and 15
r. Records and reports		Item 6
s. Inspections/audits		Items 6 and 11
t. Transfer		Item 17
u. Renewal		Item 17

Obligation	Section in Franchise Agreement	Item in Disclosure Document
v. Post-termination obligations		Item 17
w. Non-competition covenants		Item 17
x. Dispute resolution		Item 17