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# **BASICS TRACK: REGISTRATION AND DISCLOSURE**

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## **I. Franchise Regulation**

The franchise model has become an integral part of the economy. Franchisors expand their brand through networks of independent operators all using the same trademark and system. A typical franchise agreement involves significant investments of time and capital by franchisees, and, therefore, a robust body of law has developed around protecting a franchisee's interest in purchasing a franchise. Franchisors are required to comply with various state and federal laws that apply to their franchise programs.

This paper provides generally describes the federal and state regulatory laws that apply the offer and sale of franchises in the United States<sup>1</sup>, including disclosure and registration requirements.<sup>2</sup>

### **A. Federal Trade Commission's Franchise Rule**

#### **1. Purpose of the Franchise Rule**

The Federal Trade Commission's ("FTC's") Rule on Franchising (the "Franchise Rule"), which is codified at 16 C.F.R. Part 436, was first enacted in 1979.<sup>3</sup> The intent of the law was to combat instances of fraud and misrepresentation in connection with the offer and sale of franchises by requiring pre-sale disclosure and prohibiting unfair or deceptive practices.

In the FTC's view, pre-sale disclosure would provide franchisees with "at least the minimum information needed to make an informed decision whether to enter into the franchise relationship."<sup>4</sup> Importantly, the FTC's Franchise Rule does not mandate any of the business terms of the relationship "on the theory that informed investors can determine for themselves whether a particular deal is in their best interest."<sup>5</sup> Further, the Franchise Rule does not provide a private right of action that allows franchisees to seek damages or other redress based on violation of the Franchise Rule. The Franchise Rule was amended in 2007<sup>6</sup> to address developments in the industry as well as to account for new technologies and state laws that had been passed since the first version of the Franchise Rule, but many of the provisions remained.

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<sup>1</sup> The Franchise Rule governs the offer and sale of franchises throughout the United States and all US territories; Puerto Rico, Guam, Northern Mariana Islands, US Virgin Islands, and American Samoa. 16 C.F.R. § 436.2.

<sup>2</sup> This paper does not cover all aspects of representing a client who operates a franchise program and, instead, only provides an overview of the basic considerations and applicable laws.

<sup>3</sup> Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, 16 C.F.R. § 436.1 (1978).

<sup>4</sup> Statement of Basis and Purpose, 43 FR 59621 (Dec. 21, 1978) ("Original Statement").

<sup>5</sup> Statement of Basis and Purpose, 16 C.F.R. 15444, 15445 (March 30, 2007) ("Amended Statement").

<sup>6</sup> Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities; Final Rule, 72 Fed. Reg. 15444, 15478, n.350 (March 30, 2007).

## **2. What is a Franchise and When is Compliance with the FTC Franchise Rule Required?**

The Franchise Rule defines a franchise as any continuing commercial relationship or arrangement in which the franchisor: (1) grants to the franchisee the right to use the franchisor's trademark or other commercial symbol; (2) retains the right to exert significant control or agrees to provide significant assistance to the franchisee with respect to the operation of the business; and (3) charges a fee greater than \$615 during the first six months of operations.<sup>7</sup> Regardless of how the parties define their relationship, if these criteria are met, then a franchisor must comply with the Franchise Rule. Referring to the relationship by a different name or requiring a representation that the relationship is not a franchise does not avoid the application of the Franchise Rule.<sup>8</sup>

However, the Franchise Rule does not cover every relationship involving a trademark or the use of a system for operating a business. As an example, the Franchise Rule exempts single trademark licenses,<sup>9</sup> franchise relationships governed by the Petroleum Marketing Practices Act, and business opportunities.<sup>10</sup>

The Franchise Rule defines the "sale of a franchise" as "an agreement whereby a person obtains a franchise from a franchise seller for value by purchase, license, or otherwise."<sup>11</sup> The Franchise Rule's definition of a sale does not include the extension or renewal of an existing franchise agreement, if the extension or renewal agreement does not contain materially different terms and if there is no interruption in the franchisee's operation of the business. Also excluded from the definition of a sale is the transfer of a franchise agreement by an existing franchisee in which the franchisor has no significant involvement.<sup>12</sup>

## **3. Disclosure Obligations**

The Franchise Rule prescribes the information and the format of the information that a franchisor must disclose. A "Franchise Disclosure Document" ("FDD") is the common term used for the document prepared in accordance with the FTC Rule. The FDD includes 23 "Items" covering the disclosures mandated by the FTC. The Franchise Rule also requires that franchisors attached copies of all material contracts a franchisee will sign in connection with the franchise offering. Franchisors are solely responsible for ensuring the accuracy and completeness of the information included in the FDD.<sup>13</sup>

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<sup>7</sup> 16 C.F.R. § 436.1(h). The minimum fee requirement was adjusted to \$615 as of July 1, 2020.

<sup>8</sup> See, 16 C.F.R. § 436.9(h).

<sup>9</sup> 16 C.F.R. 15444, 15520 (March 30, 2007).

<sup>10</sup> 16 C.F.R. § 436.8. The Franchise Rule does not apply to business opportunities. The offer and sale of business opportunities are governed by 16 C.F.R. §437 and are not covered by this paper.

<sup>11</sup> 16 C.F.R. § 436.1(t).

<sup>12</sup> *Id.*

<sup>13</sup> 16 C.F.R. § 436.6(a).

**a. Timing for Disclosure and Delivery of the Franchise Agreement**

The Franchise Rule requires that franchisors provide each prospective franchisee with an FDD at least 14 calendar days (which, in some states, is modified to be 10 business days) before the prospect signs any binding contract with, or remits any consideration to, the franchisor or its affiliates.<sup>14</sup> When calculating the 14-calendar day waiting period, the franchisor cannot count the day that it delivers the FDD to the prospect or the 14<sup>th</sup> day after receipt of the FDD.<sup>15</sup>

Under the Franchise Rule, a franchisor may be required to provide an FDD earlier than 14 days before signing a contract or paying any amounts prospective franchisee makes a “reasonable” request for a copy of the FDD.<sup>16</sup> Reasonableness is a fact specific determination, but generally if the franchisee is a qualified candidate then the request should be considered reasonable. Franchisors often provide the FDD far in advance of the required waiting period so as to avoid timing issues later down the line.

The Franchise Rule also requires a 7 calendar day waiting period prior to signing or accepting consideration if a franchisor makes unilateral, material changes the terms of the form franchise agreement attached to the FDD or if the franchisor inserts material terms into the franchise agreement prior to execution such as the territory.<sup>17</sup> However, this waiting period does not apply if: (1) the only differences between the form agreement and the ready-for-execution version are non-substantive “fill-in-the-blank” provisions,<sup>18</sup> or (2) the modifications to the agreement reflect changes initiated at the prospective franchisee’s request.<sup>19</sup>

**b. Electronic Disclosure**

The Franchise Rule permits electronic disclosure to be made via email, CD-ROM, a secure portal (where a prospect can access the password-protected document), or through any number of third-party electronic document delivery systems.<sup>20</sup> However, the FDD cannot contain embedded pop-ups, audio, video, or links that direct the prospective franchisee to external documents.<sup>21</sup> The Franchise Rule does permit tools to help ease

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<sup>14</sup> 16 C.F.R. § 436.2(a).

<sup>15</sup> FTC, *Franchise Rule Compliance Guide* at p. 20 (May 2008), <https://www.ftc.gov/system/files/documents/plain-language/bus70-franchise-rule-compliance-guide.pdf> (“Compliance Guide”).

<sup>16</sup> 16 C.F.R. § 436.9(e).

<sup>17</sup> 16 C.F.R. § 436.2(b); Compliance Guide.

<sup>18</sup> Compliance Guide at 22. According to the Compliance Guide, “fill-in-the-blank” provisions include items such as date, name, and address of the franchisee. The addition of substantive terms such as a protected territory, interest rate, number of outlets to be opened, or other contractual terms that were not previously disclosed in the FDD or its attachments will trigger the seven-calendar-day waiting period.

<sup>19</sup> *Id.* at 23.

<sup>20</sup> 16 C.F.R. § 436.2(c).

<sup>21</sup> 16 C.F.R. § 436.6(d).

review, such as scroll bars, search features, and internal links between disclosure items and other parts of the FDD.<sup>22</sup>

The Franchise Rule further requires franchisors to advise franchisees of the available formats for and any requirements to view the FDD, such as specific software requirements.<sup>23</sup> These disclosures are often included in the correspondence when a prospective franchisee is first engaged. Franchisors are also required to provide the FDD in a format that can be saved for future viewing.<sup>24</sup> The FDD must be provided in a complete, single document and cannot be separated into parts<sup>25</sup>. This specifically includes the FDD receipts which are prohibited from being provided as a separate attachment for convenience.

## **B. State Regulation**

15 state laws impose state-specific disclosure obligations on franchisors that supersede the requirements of the Franchise Rule.<sup>26</sup> These state laws mostly follow the disclosure obligations as provided under the Franchise Rule but there are some differences. These additional, state-specific disclosure obligations are detailed further in Section II.C below.

Of the 15 states that have enacted franchise disclosure laws, 14 (“Registration States”) impose registration requirements in their respective jurisdictions.<sup>27</sup> These states require a franchisor to secure registration with the state administrator prior to engaging in the offer and sale of franchises. The registration process is described in greater detail in Section III below.

State franchise laws may also, among other things: (1) require franchisors to consent to jurisdiction within their respective states; (2) require that their respective state laws govern the franchise agreement, regardless of the governing law provision included

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<sup>22</sup> Compliance Guide at 122.

<sup>23</sup> 16 C.F.R. § 436.6(g).

<sup>24</sup> Compliance Guide at 121.

<sup>25</sup> *Id.*

<sup>26</sup> *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.*

<sup>27</sup> The Oregon Franchise Transactions law does not require registration.

in the franchise agreement; (3) empower state regulatory authorities to review FDDs to ensure compliance with applicable disclosure requirements; and (4) provide a private right of action for franchisees harmed by a franchisor's noncompliance. State regulators also typically have the power to conduct their own investigations and to impose civil and administrative fines for noncompliance.<sup>28</sup>

The North American Securities Administrators Association (“NASAA”) works to coordinate federal and state laws by proposing to the states for adoption uniform guidelines, laws, and model rules. While NASAA has no direct authority over franchising, NASAA’s recommendations and policy initiatives are of great importance to the Registration States. For example, NASAA adopted the 2008 Franchise Registration and Disclosure Guidelines (“NASAA Guidelines”) as a model for states with franchise registration and disclosure laws.<sup>29</sup> To provide further guidance, on April 27, 2009, NASAA adopted the Commentary on 2008 Franchise Registration and Disclosure Guidelines (“NASAA Commentary”).<sup>30</sup> NASAA also adopted the “Multi-Unit Commentary” on September 16, 2014<sup>31</sup> and the NASAA Commentary on Financial Performance Representations (“FPR Commentary”) on May 8, 2017.<sup>32</sup>

Reviewing the various state franchise registration and disclosure laws, the NASAA Guidelines, the NASAA Commentary, the FPR Commentary, and the Multi-Unit Commentary prior to submitting a franchise registration application to a particular state is critical to ensure sound practice.

## **II. Franchise Disclosure Document**

The Franchise Rule requires a franchisor to provide a prospective franchisee with an FDD that contains the 23 Items of disclosure that are required by the Franchise Rule. In this Section, there are FDD drafting tips and resources a practitioner should rely on while preparing FDDs (in Section II.A), a summary of the information required in each of the 23 Items (in Section II.B), and additional disclosure requirements imposed by the Registration States that go beyond those included in the Franchise Rule (in Section II.C). This summary highlights key disclosures of each Item, but it is not intended to be an exhaustive list of all required disclosures under the Franchise Rule.

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<sup>28</sup> A number of states also have “franchise relationship” statutes, which govern the circumstances under which a franchise relationship may be cancelled, terminated, not renewed, or otherwise materially changed..

<sup>29</sup> NASAA, *NASAA 2008 Franchise Registration and Disclosure Guidelines*, <http://www.nasaa.org/wp-content/uploads/2011/08/2008UFOC1.pdf> (“NASAA Guidelines”).

<sup>30</sup> NASAA, *Commentary on 2008 Franchise Registration and Disclosure Guidelines*, [www.nasaa.org/wp-content/uploads/2011/08/FranchiseCommentary\\_final.pdf](http://www.nasaa.org/wp-content/uploads/2011/08/FranchiseCommentary_final.pdf) (“NASAA Commentary”).

<sup>31</sup> NASAA, *Multi-Unit Commentary*, <http://www.nasaa.org/wp-content/uploads/2011/08/Franchise-Multi-Unit-Commentary-effective-Adopted-Sept.-16-2014.pdf> (“Multi-Unit Commentary”).

<sup>32</sup> NASAA, *NASAA Franchise Commentary Financial Performance Representations*, <http://www.nasaa.org/wp-content/uploads/2017/05/Financial-Performance-Representation-Commentary.pdf> (“FPR Commentary”).

## A. FDD Drafting Tips and Resources

The Franchise Rule requires franchisors to disclose all information clearly, legibly, and in plain English.<sup>33</sup> The Rule considers “plain English” to include words and phrases understandable by a person unfamiliar with the franchised business.<sup>34</sup> Drafters of FDDs should use short sentences, everyday language, and active voice and avoid legal jargon and highly technical business terms.<sup>35</sup> An FDD also must be a “single document” and in a form that allows a prospective franchisee to “store, download, print or otherwise maintain the document for future use.”<sup>36</sup>

When preparing an FDD, a franchisor must address every disclosure requirement outlined in the Franchise Rule.<sup>37</sup> If any required disclosure is not applicable to the franchise system, then the FDD must include a negative statement that addresses the required disclosure.<sup>38</sup> Similarly, if specific language is prescribed or required by the Rule, then the franchisor cannot modify the required language; it must be presented verbatim as specified in the Rule.<sup>39</sup> The FDD must be limited to (i) the specific requirements imposed by the Franchise Rule or state law and (ii) any specific disclosures required by a state regulator, provided that any state imposed disclosures are not inconsistent with the requirements of the Rule.<sup>40</sup> A franchisor’s inclusion of extraneous information not responsive to these specific requirements or disclosures is prohibited by the Franchise Rule.<sup>41</sup>

When making disclosures in one Item of an FDD, cross-references to other Items of the FDD can be helpful to provide readers with additional information. However, some state regulators may require the removal of these cross-references.

When drafting an or updating an FDD, the following resources may be useful.

- Amended Statement (of Basis and Purpose)<sup>42</sup>
- FPR Commentary<sup>43</sup>
- Franchise Rule<sup>44</sup>

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<sup>33</sup> 16 C.F.R. § 436.6(b); Compliance Guide at 121.

<sup>34</sup> 16 C.F.R. § 436.1(o).

<sup>35</sup> *Id.*

<sup>36</sup> 16 C.F.R. § 436.6(b); Compliance Guide at 121.

<sup>37</sup> 16 C.F.R. § 436.6(c);

<sup>38</sup> *Id.*

<sup>39</sup> Compliance Guide at 122.

<sup>40</sup> 16 C.F.R. § 436.6(d); Compliance Guide at 121-122.

<sup>41</sup> *Id.*

<sup>42</sup> Disclosure Requirements and Prohibitions Concerning Franchising, 72 Fed. Reg. 15,444 (March 30, 2007) or <https://www.ftc.gov/sites/default/files/070330franchiserulefrnotice.pdf>.

<sup>43</sup> FPR Commentary. [For a detailed discussion of the content and drafting of FPRs, see Dale Cantone, Eric Karp and Max Schott, II, Advanced Drafting of Financial Performance Representations: A Reasonable Basis](#), 39th Annual ABA Forum on Franchising (2016) (“Advanced Drafting of FPRs”).

<sup>44</sup> 16 C.F.R. § 436; Compliance Guide at 121-122.



- FTC Amended Rule FAQs<sup>45</sup>
- FTC Compliance Guide<sup>46</sup>
- FTC Informal Advisory Opinions<sup>47</sup>
- NASAA Commentary<sup>48</sup>
- NASAA Guidelines<sup>49</sup>
- NASAA Multi-Unit Commentary<sup>50</sup>

## B. Federal Disclosure Requirements

### 1. Federal Cover Page

The FDD begins with a federal cover page. The federal cover page explains to prospective franchisees the purpose of the FDD, basic information about the franchise system, and certain mechanisms designed to protect franchisees.<sup>51</sup> On the federal cover page, the Franchise Rule requires a franchisor to include specific language and other information in a required order and form. Specifically, the Franchise Rule requires the title of the FDD – “**FRANCHISE DISCLOSURE DOCUMENT**” – to appear in both capital letters and boldface type.<sup>52</sup> The title must be followed by basic information about the franchisor – i.e., name, type of business organization, principal business address, telephone number, and the franchisor’s email address and web page – the primary business trademark for the franchise system, and a brief description of the franchised business.<sup>53</sup> The federal cover page must also include the following statements:

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.<sup>54</sup>

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.**<sup>55</sup>

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<sup>45</sup> FTC Rule FAQs, <https://www.ftc.gov/tips-advice/business-center/guidance/amended-franchise-rule-faqs>.

<sup>46</sup> <https://www.ftc.gov/system/files/documents/plain-language/bus70-franchise-rule-compliance-guide.pdf>.

<sup>47</sup> <https://www.ftc.gov/policy/advisory-opinions>.

<sup>48</sup> [NASAA Commentary](#).

<sup>49</sup> [NASAA Guidelines](#).

<sup>50</sup> [Multi-Unit Commentary](#).

<sup>51</sup> 16 C.F.R. § 436.3.

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> 16 C.F.R. § 436.3(e)(1).

<sup>55</sup> 16 C.F.R. § 436.3(e)(2).

[OPTIONAL] 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].<sup>56</sup>

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.<sup>57</sup>

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](http://www.ftc.gov) for additional information. Call your state agency or visit your public library for other sources of information on franchising.<sup>58</sup>

There may also be laws on franchising in your state. Ask your state agencies about them.<sup>59</sup>

Finally, the federal cover page must include the issuance date of the FDD, which is the date that the franchisor finalizes the FDD.<sup>60</sup>

On May 19, 2019, NASAA issued new guidelines requiring changes to the structure, content, and overall format of the FDD State Cover Page and the Effective Date Page. These new guidelines and requirements can be found at <https://www.nasaa.org/wp-content/uploads/2019/06/New-Franchise-State-Cover-Sheets-Instructions.pdf>, and become effective January 1, 2020, for all FDDs issued in 2020 and thereafter.

Under the new State Cover Page framework, NASAA added three new state cover sheets to be included in an FDD. The first two – titled "How to Use this Franchise Disclosure Document" and "What You Need to Know About Franchising, *Generally*" – are brand new cover sheets and must be located immediately following the federal cover page.<sup>61</sup> Within each of these sections, NASAA has issued and mandated specific

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<sup>56</sup> 16 C.F.R. § 436.3(f).

<sup>57</sup> 16 C.F.R. § 436.3 (e)(3).

<sup>58</sup> 16 C.F.R. §436.3 (e)(4).

<sup>59</sup> 16 C.F.R. §436.3 (e)(5).

<sup>60</sup> Compliance Guide at 26.

<sup>61</sup> NASAA, *NASAA New Franchise State Cover Sheets Instructions*, (May 19, 2019), <https://www.nasaa.org/wp-content/uploads/2019/06/New-Franchise-State-Cover-Sheets-Instructions.pdf> (last visited April 24, 2022).

information and content and provides guidance as to font sizes and formatting. The purpose of these new cover sheets is to provide prospective franchisees with clearer direction as how to use the FDD and more general information about franchising and the franchise relationship.

The third, new cover sheet – titled “Special Risk(s) to Consider about *This Franchise*” – replaces the current state cover page.<sup>62</sup> It includes one standard risk factor relating to out-of-state dispute resolution and allows states to require additional risk factors. However, to promote uniformity and reduce repetition, non-uniform risk factors required by a particular state may be included in a state addendum to the FDD, rather than on the cover sheet, in which case, the following statement must be included at the end of the page: “Certain states may require other risks to be highlighted. If so, check the “State Specific Addenda” pages for your state.”<sup>63</sup> Risk factors also must be in lower case text, instead of all capital letters, to make them easier to read.<sup>64</sup>

Finally, the franchisors must place State Effective Dates page to the end of the FDD, immediately before the acknowledgment of receipt pages required under Item 23.<sup>65</sup>

## **2. Item 1: The Franchisor and Any Parents, Predecessors, and Affiliates**

Item 1 requires disclosure of an overview of the franchise opportunity and the type of business the franchisee will operate. The franchisor must also disclose background information on the franchisor and any parent, affiliate, or predecessor and whether or not any parent, affiliate, or predecessor operates the business being franchised or offer franchises for any other line of business.<sup>66</sup> All parents in the chain of ownership must be disclosed, not just the immediate parent or the “ultimate” parent.<sup>67</sup> Franchisors also must disclose any other business activities in which they engage and the franchisor’s agent for service of process.<sup>68</sup>

Item 1 also requires a description of the market for the franchise’s goods or services, the competition that a franchisee will face, and a general description of any laws or regulations that are specific to the industry in which the franchise will be operated.<sup>69</sup> The description of the laws however, does not include laws that affect all businesses generally, only those that are specific to the type of business the franchisee will operate.<sup>70</sup> Laws that pertain to businesses in general are not required to be disclosed.<sup>71</sup>

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<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Id.*

<sup>66</sup> 16 C.F.R. § 436.5(a).

<sup>67</sup> Compliance Guide at 29.

<sup>68</sup> 16 C.F.R. §436.5(a).

<sup>69</sup> 16 C.F.R. § 436.5(a).

<sup>70</sup> Compliance Guide at 31.

<sup>71</sup> Compliance Guide at 31.

### 3. Item 2: Business Experience

Item 2 requires disclosure of the business experience for the past five years of its directors, principal officers, trustees, general partners, and all other individuals who will have “management responsibility” related to the sale or operation of franchises.<sup>72</sup> The biographies in this Item should be limited to the 5 years before the FDD’s issuance date. Franchisors must make the disclosures in Items 3 and 4 for each individual listed in Item 2.

The Franchise Rule requires the inclusion of “any other individuals who will have management responsibility relating to the sale or operation of franchises,” offered by the FDD, not all managers must be disclosed.<sup>73</sup> It does not matter whether the individuals with management responsibility are employed by the franchisor, an affiliate, or by a parent company. As long as the individual actively manages the sale of franchises or the operation of franchises, that individual's business experience should be noted in the Item 2 disclosure. “[S]ales and operations managers, regardless of whether they have a formal title, should be disclosed if their involvement in either sales or operations is such that a prospective franchisee would rely on their expertise, formulation of policy, or control of the system in making an investment decision.”<sup>74</sup>

### 4. Item 3: Litigation

Item 3 requires disclosure of information regarding three types of disputes: (1) certain pending administrative, criminal, and material civil actions, (2) material lawsuits involving the franchise relationship filed in the last fiscal year, and (3) certain prior actions within the last 10 years.<sup>75</sup>

Two types of pending actions must be disclosed. The first type involves any administrative, criminal, or material civil action that alleges a violation of a franchise, antitrust, or securities law, or that alleges fraud, unfair or deceptive trade practices, or comparable allegations.<sup>76</sup> A material civil action means “one that is likely to influence a prospective franchisee’s investment decision.”<sup>77</sup> The second type of pending action that must be disclosed consists of “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.”<sup>78</sup> These factors must be weighed on a case-by-case basis to determine whether any particular civil action is material and therefore must be disclosed. Regardless of the merit of these pending claims, a franchisor must disclose them if they fit within one of the two categories.

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<sup>72</sup> 16 C.F.R. § 436.5(b); Compliance Guide at 33.

<sup>73</sup> *Id.*

<sup>74</sup> Compliance Guide at 33.

<sup>75</sup> 16 C.F.R. § 436.5(c).

<sup>76</sup> 16 C.F.R. § 436.5(c)(1)(i)(A); Compliance Guide at 35.

<sup>77</sup> Compliance Guide at 35.

<sup>78</sup> 16 C.F.R. § 436.5(c)(1)(i)(B); Compliance Guide at 35.

Additionally, the franchisor must disclose any material civil action involving the franchise relationship in the last fiscal year -- that is, actions relating to the parties' contractual obligations (such as royalty payment and training obligations).<sup>79</sup> As such, actions involving third parties, such as suits by a franchisor against a supplier are specifically excluded. Only those material lawsuits that were filed (not pending) in the previous fiscal year by or against the franchisor or its predecessors, and in some cases its affiliates or its parent, or any person identified in Item 2, are required to be disclosed.<sup>80</sup> Actions are considered material if they are likely to influence a prospective franchisee's investment decision.<sup>81</sup> In addition, a franchisor may disclose in summary fashion franchisor-initiated actions of this type under a common heading, provided no counterclaims or other claims were filed by the defendants in the action that would otherwise require a more expansive disclosure in Item 3.<sup>82</sup> Franchisor-initiated actions generally consist of collection actions against current and former franchisees and actions to enforce non-compete covenants and system standards. Suits initiated by a franchisor against a franchisee for indemnification of tort liability are excluded.

Further, a franchisor must disclose prior lawsuits and currently effective administrative actions against the franchisor or any of its predecessors, parents, or affiliates, or any person identified in Item 2 that have occurred during the 10-year period preceding the date of the FDD in which the franchisor-related party was convicted of or plead nolo contendere to a felony charge or was held liable for violations of a franchise, antitrust, or securities law, or fraud, unfair or deceptive trade practices, or comparable allegations.<sup>83</sup> For each of these matters, the franchisor must describe specific information about the particular action and provide a summary of the relief sought or obtained and any conclusions of law or fact.<sup>84</sup> For this disclosure, "held liable" means that a party was required to pay money or other consideration, was required reduce an indebtedness by the amount of an award, was not allowed to enforce its rights, or was required to take action adverse to its interests.<sup>85</sup> Accordingly, dismissals need not be disclosed. If a formal settlement agreement must be disclosed, then all material terms of the settlement must be disclosed, whether or not the agreement is confidential. However, franchisors need not disclose the terms of any confidential settlements entered into before the franchisor commences franchise sales.

## **5. Item 4: Bankruptcy**

Item 4 requires disclosure of all bankruptcies that have occurred during the 10-year period preceding the date of the FDD which involve the franchisor; any of its predecessors, parents, or affiliates; or any of the persons disclosed in Item 2.<sup>86</sup> If a

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<sup>79</sup> 16 C.F.R. § 436.5(c)(1)(ii); Compliance Guide at 36.

<sup>80</sup> *Id.*

<sup>81</sup> Compliance Guide at 36..

<sup>82</sup> 16 C.F.R. § 436.5(c)(4).

<sup>83</sup> 16 C.F.R. § 436.5(c)(1)(iii) and (2); Compliance Guide at 37.

<sup>84</sup> 16 C.F.R. § 436.5(c)(3).

<sup>85</sup> 16 C.F.R. § 436.5(c)(1)(iii)(B); Compliance Guide at 37.

<sup>86</sup> 16 C.F.R. § 436.5(d).

franchisor has no bankruptcy information to report, the franchisor should state "[N]o bankruptcy is required to be disclosed in this Item."

## **6. Item 5: Initial Fees**

Item 5 requires disclosure of the amount and types of fees collected by the franchisor or its affiliates from the franchisee prior to the opening of the franchised business, including the initial franchise fee.<sup>87</sup> There is no requirement to disclose pre-opening fees that are paid directly to third parties before the franchisee's business opens. The Franchise Rule also requires the franchisor to disclose whether the fees are uniformly imposed on all franchisee prospects and whether any of the required fees are refundable.<sup>88</sup> Where any of the initial fees are not uniformly imposed, the franchisor must provide the range of fees collected during its prior fiscal year or the formula used to determine the amount of the fee paid by each franchisee.<sup>89</sup> If any fee may be paid in installments, the franchisor must disclose the payment terms either in Item 5 or in Item 10.

## **7. Item 6: Other Fees**

Item 6 requires disclosure of all fees associated with operating a franchised outlet that the franchisee will or may pay to the franchisor and its affiliates, other than the initial fees already disclosed under Item 5.<sup>90</sup> This disclosure is to be made in a prescribed four-column table describing the type of fee, amount of the fee, and the due date. Any remarks, definitions, caveats or other information that is necessary to clarify the fees disclosure can be made in the remarks column in the table, or in footnotes to the tables.

Other fees includes both recurring fees such as royalties and advertising fund contributions and occasional fees such as transfer or renewal fees. In addition to royalties and advertising contributions, many franchisors charge, or reserve the right to charge, other fees in certain circumstances, such as when a franchisee is required to indemnify the franchisor or when liquidated damages are imposed. Many franchisors reserve the right to be reimbursed for certain costs they incur on behalf of franchisees. Payments made to, or collected by, the franchisor (or one of its affiliates) as a pass-through of fees imposed by third parties (such as a lease deposit for a sublease or licensing fees for third-party software) must also be disclosed, but fees paid directly to a third party are not required to be disclosed.<sup>91</sup> Franchisors should review their practices to make sure that all fees, payments, and reimbursements that it requires are accurately reflected in Item 6 and that the provisions in the franchise agreement are consistent with the Item 6 disclosures.

In addition to identifying all of the types of fees that are required to be included in Item 6, the disclosure must include a description of the nature and frequency of each fee,

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<sup>87</sup> 16 C.F.R. § 436.5(e).

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> 16 C.F.R. § 436.5(f).

<sup>91</sup> Compliance Guide at 45.

including whether or not such fee is subject to adjustment, and if so, on what basis the fee may increase. For example, a percentage of gross sales is an acceptable formula, provided the franchisor defines what it means by "gross sales." As with the disclosure in Item 5, franchisors must also disclose whether the fees in Item 6 are uniformly imposed among all franchisees and outlets, and whether (and under what circumstances, if any) the fees are refundable.<sup>92</sup>

## **8. Item 7: Estimated Initial Investment**

Item 7 requires the disclosure, in a prescribed five-column table, of the estimated initial investment costs a franchisee can expect to incur to construct and open its franchised business and the additional funds necessary to operate the franchised business during the "initial period" of operations.<sup>93</sup> The length of the "initial period" may vary from franchisor to franchisor, but generally, must be at least three months.<sup>94</sup> The period may be longer if a longer period is reasonable for the industry.<sup>95</sup>

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.<sup>96</sup> Many of these expenses are often paid to third parties and are not previously disclosed in Items 5 or 6. Accordingly, Item 7 gives prospective franchisees a much more detailed picture of their likely investment than Item 5 and Item 6. The list of expenditures in Item 7 is not meant to be exhaustive because each franchisee's experience is unique and may vary from other outlets from which the cost estimates were compiled. Despite this, certain categories of costs are fairly standard throughout most franchise systems including (1) initial franchise fee, (2) training expenses, (3) real property (purchased or leased), (4) leasehold or capital improvement, (5) furniture, fixtures, and equipment, (6) beginning inventory, (7) business licenses and fees, and (8) a category for "additional funds" which are additional monies a franchisee likely needs during the "initial phase" of operations, typically three months after opening.<sup>97</sup> In addition to these typical expenses, franchisors must itemize and identify any other specific required payments such as additional training, travel, and advertising expenses that franchisees will incur to begin operations.

The number and types of fees will necessarily vary depending upon the nature of the franchised business. For instance, some franchisees incur costs for deposits, site selection fees, real estate brokerage fees, insurance, and professional fees, and these types of costs should not be overlooked.

The second column of the Item 7 table requires the franchisor to provide a dollar amount for each type of cost. Most franchisors provide a low-to-high range based on the experience of the franchisor, its franchisees, and market research. The notes to Item 7 should be used to explain any assumptions made by the franchisor about the range of

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<sup>92</sup> 16 C.F.R. § 436.5(f)(4).

<sup>93</sup> 16 C.F.R. § 436.5(g).

<sup>94</sup> Compliance Guide at 49.

<sup>95</sup> *Id.*

<sup>96</sup> 16 C.F.R. § 436.5(g).

<sup>97</sup> 16 C.F.R. § 436.5(g)(1)(i)-(iii).

estimated costs, the variability of the costs disclosed, the methodology used to make any calculations, and any differences that may impact individual franchisees. In addition, if the franchisor (or affiliate) finances part of the initial investment, the amount financed, the required down payment, the annual interest rate, rate factors, and the estimated loan repayments must be disclosed. 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. If a low-to-high range is used in Item 7, then the total amount should also reflect a low-to-high range.

## **9. Item 8: Restrictions on Sources of Products and Services**

Item 8 requires disclosure of any restriction that the franchisor imposes on the source of products and services its franchisees are required to use. For each restriction, the franchisor must explain: (1) the item that the franchisee is required to purchase or lease; (2) the designated or approved supplier(s) for that item (including whether the franchisor or its affiliates are the only supplier one of the approved suppliers); (3) whether the franchisor or any of its affiliates or management team owns an interest in any designated or approved supplier; (4) whether the franchisor issues specifications and standards for the item and how those specifications are modified; and (5) the process the franchisor uses to grant and revoke approval of a particular supplier.<sup>98</sup>

Some franchisors, or their affiliates, receive rebate payments and other types of consideration and benefits from suppliers based on the volume of purchases by the franchise system, and when they do, the franchisor must disclose the precise basis for these types of payments and benefits and the amount of revenue that the franchisor receives from suppliers.<sup>99</sup> If the franchisor or its affiliates received revenue from required purchases by franchisees in the prior fiscal year, Item 8 must include a description of the "precise basis" upon which the franchisor or its affiliates derived such revenues or other benefits, by disclosing, as applicable: (1) the franchisor's total revenue, (2) the franchisor's revenues from all required purchases and leases of products and services by franchisees, (3) the percentage of the franchisor's total revenues that come from purchases or leases by franchisees that are required by the franchisor, and (4) the revenues received by affiliates of the franchisor from purchases or leases by franchisees that are required by the franchisor.<sup>100</sup> For the purchases from approved suppliers, the franchisor must include information on how the franchisor will evaluate and approve alternative suppliers that a franchisee might propose to use and how the franchisor will revoke its approval if previously granted.

Finally, Item 8 requires franchisors to address other areas that relate to purchases made by franchisees including the following: (1) the estimated percentages of a franchisee's required purchases and leases in proportion to all purchases and leases by a franchisee in both establishing and operating the franchised business; (2) whether there are purchasing cooperatives in the franchise system; (3) whether the franchisor negotiates purchasing terms with suppliers; and (4) whether the franchisor provides any

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<sup>98</sup> 16 C.F.R. § 436.5(h).

<sup>99</sup> 16 C.F.R. § 436.5(h)(8); Compliance Guide at 53-55.

<sup>100</sup> 16 C.F.R. § 436.5(h)(6); Compliance Guide at 54-55.



material benefit to franchisees that purchase product from a designated or approved supplier.<sup>101</sup>

## **10. Item 9: Franchisee's Obligations**

Item 9 requires that the franchisor complete a three-column table that cross-references and describes: (1) a list of the franchisee's obligations under the franchise agreement (or any other relevant agreement between franchisor and franchisee, such as a multi-unit development agreement), (2) the section in that agreement that contains the franchisee's obligations, and (3) the corresponding "Item" in the FDD that discusses the obligation.<sup>102</sup> The obligations that must be listed in the Item 9 table for cross references are specified by the Rule, even if the franchisor merely states "Not Applicable" next to certain of those obligations. Franchisors can also add additional obligations that are applicable to their franchise system by adding those obligations at the end of the table. A mandatory statement, written in bold type, is required to be placed just above the Item 9 table. A sample Item 9 table is attached as Exhibit A.

## **11. Item 10: Financing**

Item 10 requires the franchisor to disclose whether or not the franchisor (or any of its affiliates or agents) provides any financing (directly or indirectly) to franchisees. The term financing is interpreted broadly to include guaranties of franchisee loan and lease obligations.<sup>103</sup> If the franchisor provides one of these types of financing, Item 10 must explain the financing arrangement, the lender and the relationship between the lenders and the franchisor, as well as the key terms of the financing arrangement. Franchisors are permitted to disclose this information in a table, and an example of an Item 10 table is attached as Exhibit B.<sup>104</sup> However, franchisors are permitted to disclose the information in another format, and if a table is used, most franchisors supplement the information in the table with explanatory notes. If franchisees are required to enter into any required agreements related to the financing, those agreements must be included in Item 22. If a franchisor does not offer a financing arrangement, the franchisor should state "[W]e do not offer direct or indirect financing. We do not guarantee your note, lease, or obligation."

## **12. Item 11: Franchisor's Assistance, Advertising, Computer Systems, and Training**

Item 11 is perhaps the most extensive item of disclosure in the FDD and covers the various forms of assistance that the franchisor provides to its franchisees. This Item contains a significant amount of information that is not only required by the Franchise Rule but also by NASAA.

The first disclosure in Item 11 requires that the franchisor disclose its pre-opening and ongoing obligations to its franchisees and provide references to the sections in the

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<sup>101</sup> 16 C.F.R. § 436.5(h)(7),(9)-(11); Compliance Guide at 53-55.

<sup>102</sup> 16 C.F.R. § 436.5(i).

<sup>103</sup> 16 C.F.R. § 436.5(j).

<sup>104</sup> *Id.*

agreement that establish each obligation.<sup>105</sup> Prior to the disclosure of the specific types of assistance that the franchisor will provide, Item 11 requires that the following language be included, in bold type: **“Except as listed below, [the franchisor] is not obligated to provide you with any assistance.”**<sup>106</sup> This warning is intended to alert prospective franchisees, and to counter any misrepresentation to the contrary. Following this introduction, most franchisors list the specific types of assistance in separate, numbered paragraphs, with each one identifying the specific pre-opening assistance provided to franchisees (such as site location assistance and site approval requirements) and the specific continuing assistance provided after the franchised business begins operations (such as ongoing support).<sup>107</sup> All of the franchisor’s obligations to provide assistance must be disclosed.

The Franchise Rule provides a list of possible obligations that the franchisor may undertake, but the franchisor is only required to disclose those obligations that apply to its franchise system.<sup>108</sup> Some franchisors make disclosures in Item 11 about assistance that may or may not be provided at the option of the franchisor or make disclosures about rights that are reserved - but, such information set out separately and clearly identified as assistance that is not required by the franchise agreement. In keeping with the guidance that the FDD should only contain those disclosures that are permitted, some state examiners will require that disclosures about these types of “optional” assistance be removed from the FDD.

Item 11 also requires specific disclosures with respect to certain types of assistance provided by the franchisor. First, the franchisor must describe its advertising programs including: (1) whether the franchisee must conduct local advertising; (2) the types of media used for advertising (e.g., print, radio, television, internet); (3) the source of the advertising; (4) the geographical scope of advertising (e.g., local, regional, or national); (5) whether franchisees must contribute to an advertising fund or spend any specific amounts toward advertising in their local markets; and (6) the role of advertising councils or cooperative associations (and a description of how they operate).<sup>109</sup> With respect to advertising funds, franchisors must disclose the amount of the franchisee’s required contribution to the fund and the uses of the monies held in the fund during the preceding year.<sup>110</sup>

Item 11 also requires that franchisors provide a general description in non-technical language of the computer systems (including POS systems and electronic transaction/purchase systems) that franchisees must purchase or lease and the costs associated with those systems.<sup>111</sup> Franchisors must also identify: (1) whether the franchisor, an affiliate, or a third party will provide ongoing maintenance, repairs, upgrades, or updates and the franchisee’s related costs; (2) the cost to purchase or lease

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<sup>105</sup> 16 C.F.R. § 436.5(k).

<sup>106</sup> *Id.*

<sup>107</sup> 16 C.F.R. § 436.5(k)(1) and (3).

<sup>108</sup> *Id.*

<sup>109</sup> 16 C.F.R. § 436.5(k)(4).

<sup>110</sup> 16 C.F.R. § 436.5(k)(4)(v).

<sup>111</sup> 16 C.F.R. § 436.5(k)(5).

the system whether the franchisee has any obligation to upgrade or update the systems; (3) whether there is any contractual limitation on the frequency and cost of such upgrades or updates; and (4) whether the franchisor has access to the data that is captured on those systems.<sup>112</sup> In addition, for some start-up franchisors, the computer system requirements may not have been finalized. The Compliance Guide specifically provides that a franchisor may indicate that the computer requirements are yet to be determined or otherwise state its policy concerning computer system or electronic purchase systems.<sup>113</sup> As such, the fact that a start-up franchisor has not finalized its plans for electronic cash registers or computer systems is itself material information to disclose to prospective franchisees.

Finally, Item 11 requires disclosures about the training program in a specific table entitled "TRAINING PROGRAM" that explains the requirements for both "on-the-job" training and classroom training. The subject matter and number of hours for each aspect of training must be included in a table following a specific format. Franchisors must identify: (1) the individuals within the franchisee's organization who must attend training; (2) whether all or some of franchisee's attendees must successfully complete training; and (3) the costs to attend training, such as tuition and travel costs. The franchisor also must identify the instructors who will conduct and administer the training and the length of experience each trainer has in the field of his or expertise and the length of time each trainer has worked for the franchisor. The location of the training and the timing of the training classes must also be addressed in Item 11.<sup>114</sup>

Most franchisors disclose the table of contents of their operations manual to meet the applicable Item 11 disclosure requirements regarding operations manuals.<sup>115</sup> The table of contents must disclose the total number of pages in the franchisor's operation's manual, and for each section of the manual, either the range of pages for the subject or the total number of pages for the subject. Even if the franchisor's operations manual is completely online and does not contain the same type of table of contents that is typically found in a hardcopy operations manual, the table of contents and page counts described above must be included in Item 11. Alternatively, a franchisor may provide a copy of the entire manual to prospective franchisees prior to consummating a franchise sale or provide them access to the operations manual online.<sup>116</sup> If the franchisor chooses this alternative, the franchisor will likely want each prospect to sign a confidentiality agreement and thus must also disclose that requirement and include the form of confidentiality agreement as an exhibit to the FDD.

### **13. Item 12: Territory**

Item 12 requires disclosure about where the franchised business may be located and whether the franchise agreement grants franchisees any protected territory associated with the location of the franchised business. Franchisors must disclose

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<sup>112</sup> *Id.*

<sup>113</sup> Compliance Guide at pp. 66-67.

<sup>114</sup> 16 C.F.R. § 436.5(k)(7).

<sup>115</sup> 16 C.F.R. § 436.5(k)(6); Compliance Guide at pp. 67-68.

<sup>116</sup> *Id.*

whether franchises are sold for specific locations, for a specific territory, or some combination of the foregoing. If the franchisor grants a specific territory, the disclosure must explain: (a) the methodology the franchisor uses to determine the territory and how it is designated, such as a radius, zip codes or an area encompassing a certain population; (b) any conditions the franchisee must meet to obtain and/or maintain geographic protection; and (c) any restrictions placed on the franchisor and franchisee within the territory.<sup>117</sup> Further, the franchisor must specify whether or not, and to what extent, a franchisee may solicit sales outside of their specific territory, including through other channels of distribution, such as the Internet, catalog sales, telemarketing or other direct marketing.<sup>118</sup>

If a franchisor grants its franchisees a specific territory, it must disclose whether the territory is exclusive.<sup>119</sup> A territory is considered exclusive if the “franchisor promises not to establish either a company-owned or franchised outlet selling the same or similar goods or services under the same or similar trademarks or service marks” within the territory.<sup>120</sup> A common practice among franchisors, however, is to reserve to themselves the right to establish company-owned and franchised outlets similar to the franchised outlets at “non-traditional venues” within a franchisee’s territory. Depending on the type of franchise being offered, non-traditional venues may include airports or other transportation terminals, sports arenas, stadiums and facilities, hospitals, schools, college and university campuses, corporate campuses, health clubs, military bases, casinos, convention centers, theme and amusement parks, hotels, mall kiosks or enclosed shopping centers, fairs or festivals, or other similar types of “captive” locations that have a restricted trade area. If a franchisor reserves to itself the right to establish company-owned and franchised outlets similar to the franchised outlets at non-traditional venues within a franchisee’s territory, then the franchisee’s territory is not considered exclusive for the purposes of Item 12.<sup>121</sup> This is true even if a franchisor promises not to establish outlets similar to the franchised outlets at any locations other than non-traditional locations within the franchisee’s territory.

If a franchisor does not grant its franchisees an exclusive territory, it must include the following statement in Item 12 of its FDD:

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.<sup>122</sup>

A franchisor also is required to disclose in Item 12 the rights it reserves to itself and its affiliates to solicit and accept orders from customers inside a franchisee’s territory and compensation the franchisor must pay to the franchisee for any such orders, if any.<sup>123</sup>

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<sup>117</sup> 16 C.F.R. §436.5(l).

<sup>118</sup> 16 C.F.R. §436.5(l)(6)(ii).

<sup>119</sup> 16 C.F.R. §436.5(l)(5).

<sup>120</sup> FTC FAQ #25.

<sup>121</sup> FTC FAQ #37.

<sup>122</sup> 16 C.F.R. §436.5(l)(5)(i).

<sup>123</sup> 16 C.F.R. §436.5(l)(6)(i).

This disclosure must include a description of “whether the franchisor or an affiliate has used or reserves the right to use other channels of distribution, such as the Internet, catalog sales, telemarketing, or other direct marketing sales, to make sales within the franchisee’s territory,” either using the franchisor’s principal trademarks or other trademarks.<sup>124</sup> These disclosures are required regardless of whether the franchisor provides an exclusive territory. In addition, a franchisor must disclose whether it or an affiliate “operates, franchises or has plans to operate or franchise a business under a different trademark and that business sells goods or services similar to those the franchisee will offer” and, if they do, the franchisor must disclose certain information about these businesses or potential businesses.<sup>125</sup>

Further, a franchisor must state in Item 12 any conditions upon which it will allow the franchisee to relocate the franchised business, establish new outlets, or obtain options, rights of first refusal, or other rights to acquire additional franchises.<sup>126</sup> Finally, a franchisor is required to state whether it offers area development agreements. This disclosure must include the key territorial provisions of the area development agreement.<sup>127</sup>

#### **14. Item 13: Trademarks**

Item 13 requires disclosure about the franchisor's “principal trademarks,” which are defined as “the primary trademarks, service marks, names, logos, and commercial symbols the franchisee will use to identify the franchised business.”<sup>128</sup> Specifically, for each principal trademark, a franchisor must include information regarding its registration status with the United States Patent and Trademark Office (“USPTO”), any limitations on the franchisee’s use of the mark (through settlement agreement, pending litigation, other superior rights, or otherwise), whether the franchisor knows of any superior prior rights or infringing uses that could materially affect the franchisee's use of the principal trademarks in the state where the franchised business will be located, and whether the marks have been contested (such as in any court action or administrative proceeding).<sup>129</sup> A franchisor may include in Item 13 an attorney’s opinion as to the merits of any court action or administrative proceeding relating to the principal trademark(s), provided that the attorney issuing the opinion consents to its inclusion.<sup>130</sup> These disclosures are designed to allow the franchisee to determine the strength and validity of the trademark license granted under the franchise agreement.

If a franchisor has not registered its principal trademark with the USPTO (pending applications with the USPTO do not count as registrations), it must include the following provision:

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<sup>124</sup> *Id.*

<sup>125</sup> 16 C.F.R. §436.5(l)(6)(iii).

<sup>126</sup> 16 C.F.R. §436.5(l)(3)-(4).

<sup>127</sup> 16 C.F.R. §436.5(l)(2).

<sup>128</sup> 16 C.F.R. §436.5(m)(1).

<sup>129</sup> 16 C.F.R. § 436.5(m).

<sup>130</sup> 16 C.F.R. § 436.5(m)(6).

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.<sup>131</sup>

In addition, a franchisor must disclose certain information regarding its obligations to protect a franchisee's right to use the principal trademarks and to protect, defend and indemnify the franchisee against claims of infringement or unfair competition arising out of its use of the trademarks, and the parties' rights relating to the control of these claims.<sup>132</sup> A franchisor also is required to disclose a franchisee's obligations to notify the franchisor of any potentially infringing uses of, or claims of rights to, the principal trademarks or similar trademarks.<sup>133</sup> A franchisor must describe the franchisee's rights under the franchise agreement if the franchisor requires the franchisee to modify or discontinue using a trademark.<sup>134</sup>

## **15. Item 14: Patents, Copyrights and Proprietary Information**

Item 14 requires a franchisor to disclose certain information relating to any patents, copyrights, or other intellectual property that are material to the operation of the franchised business and licensed to the franchisee under the franchise agreement.<sup>135</sup> A franchisor also must disclose in Item 14 whether its system contains any trade secrets and, if so, a brief description of such trade secrets.<sup>136</sup> This disclosure helps prospective franchisees understand the intellectual property, including trade secrets and other confidential information, they will receive by joining the franchisor's system.

Similar to the Item 13 disclosure requirements relating to trademarks, for each patent or copyright, the franchisor must include information in Item 14 regarding its registration status with the USPTO or United States Copyright Office, any limitations on the franchisee's use of the patent or copyright (through settlement agreement or otherwise), and whether the patent or copyrights have been contested (such as in any court action or administrative proceeding).<sup>137</sup> A franchisor may include in Item 14 an attorney's opinion as to the merits of any court action or administrative proceeding relating to a patent or copyright, provided that the attorney issuing the opinion consents to its inclusion.<sup>138</sup>

In addition, as with a franchisor's principal trademarks, a franchisor must disclose certain information regarding its obligations to protect a franchisee's right to use patents and copyrights, and to protect, defend, and indemnify the franchisee against claims of

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<sup>131</sup> 16 C.F.R. § 436.5(m)(4).

<sup>132</sup> 16 C.F.R. § 436.5(m)(8).

<sup>133</sup> 16 C.F.R. § 436.5(m)(8)(ii).

<sup>134</sup> 16 C.F.R. § 436.5(m)(8)(vi).

<sup>135</sup> 16 C.F.R. § 436.5(n).

<sup>136</sup> 16 C.F.R. § 436.5(n)(7).

<sup>137</sup> 16 C.F.R. § 436.5(n).

<sup>138</sup> 16 C.F.R. § 436.5(n)(3).

infringement or unfair competition arising out of its use of the patents or copyrights, and the party's rights relating to the control of these claims.<sup>139</sup> A franchisor also is required to disclose whether its obligations relating to these claims are contingent upon a franchisee notifying the franchisor of any infringement claims of which they become aware.<sup>140</sup> Additionally, a franchisor must describe the franchisee's rights under the franchise agreement if the franchisor requires the franchisee to modify or discontinue using the subject matter covered by a patent or copyright.<sup>141</sup>

#### **16. Item 15: Obligation to Participate in the Actual Operation of the Franchised Business**

Item 15 requires disclosure of the franchisee's obligations to participate personally in the direct operation of the franchised business and whether the franchisor recommends such participation.<sup>142</sup> Whatever the requirements, a franchisor must disclose them in Item 15, including the minimum experience, equity requirements, and any confidentiality or other covenants required of a third-party manager (if permitted).<sup>143</sup> As a best practice, most franchisors also disclose in Item 15 whether a franchisor will require a guaranty from the franchisee's owners, shareholders, members, or partners, and their respective spouses, if the franchisee is a legal entity.

#### **17. Item 16: Restrictions on What the Franchisee May Sell**

Item 16 requires disclosure of whether the franchisee may sell only items approved by the franchisor, whether the franchisee must sell all goods and services authorized by the franchisor, and whether there are limitations that restrict access to certain customers.<sup>144</sup> Furthermore, franchisors must disclose whether they have the right to change the types of goods and services franchisees are required to sell at their franchised business and whether there are any limitations on the franchisor's right to prescribe such changes.<sup>145</sup>

#### **18. Item 17: Renewal, Termination, Transfer, and Dispute Resolution**

Item 17 requires disclosure in a tabular format of certain key contractual terms from the franchise and related agreements that govern the franchise relationship.<sup>146</sup> The terms that must be disclosed in the form table titled "THE FRANCHISE RELATIONSHIP" include the following: (1) the length of the term of the franchise relationship, (2) any rights the franchisee may have to renew the franchise agreement, (3) the circumstances under which the franchisor and franchisee may terminate the relationship, (4) any restrictions

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<sup>139</sup> 16 C.F.R. § 436.5(n).

<sup>140</sup> 16 C.F.R. § 436.5(n)(5)(i).

<sup>141</sup> 16 C.F.R. § 436.5(n)(5)(vi).

<sup>142</sup> 16 C.F.R. § 436.5(o).

<sup>143</sup> 16 C.F.R. § 436.5(o)(2).

<sup>144</sup> 16 C.F.R. § 436.5(p).

<sup>145</sup> 16 C.F.R. § 436.5(p)(3).

<sup>146</sup> 16 C.F.R. § 436.5(q).

on either party's right to transfer, (5) the franchisee's non-compete covenants during the term of the agreement, (6) the franchisee's non-compete covenants once the agreement as expired or has been terminated, (7) the law governing the franchise agreement and any agreement material to the relationship, and (8) the dispute resolution procedures material to the relationship.<sup>147</sup> A copy of the form Item 17 table is attached hereto as Exhibit C.

## **19. Item 18: Public Figures**

Item 19 required disclosure of the nature of any affiliation that the franchise system has with a public figure, including whether the public figure is involved in ownership or management of the franchise system, and whether the franchisor compensates the public figure.<sup>148</sup> A "public figure" is defined as a person whose name or physical appearance is generally known to the public in the geographic area where the franchise will be located, and generally would include sports stars, actors, musicians, and similar celebrities. If the public figure is a paid spokesperson, the franchisor also must include the details of the compensation arrangement.<sup>149</sup> Item 18 does not, however, require a franchisor to disclose any public figures that help attract customers to the products and services associated with the franchised system and brand, so long as the public figures do not speak to, or participate in the marketing of, the offer and sale of franchises.<sup>150</sup>

## **20. Item 19: Financial Performance Representations**

The Franchise Rule, the FPR Commentary, and state laws strictly regulate the form and substance of what are currently referred to as "financial performance representations" or "FPRs," and were once more commonly known as "earnings claims."<sup>151</sup>

Section 436.1(e) of the Franchise Rule defines a "financial performance representation" broadly, as follows:

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

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<sup>147</sup> *Id.*

<sup>148</sup> 16 C.F.R. § 436.5(r).

<sup>149</sup> 16 C.F.R. § 436.5(r)(1).

<sup>150</sup> Compliance Guide at 84.

<sup>151</sup> The FTC elected to use in the Franchise Rule the term "financial performance representation" or "FPR", in place of the long used term "earnings claims," presumably recognizing that certain types of franchise systems use unique metrics beyond "earnings" to assess the financial strength of their businesses. For example, hotel franchisors often focus on occupancy rates, ADR (average daily rates) and REVPAR (revenue per available room).



calculation that shows possible results based on a combination of variables.<sup>152</sup>

An FPR includes any financial information, whether based on historic results or projections, the franchisor provides to a prospective franchisee that allows them to assess the sales, income or profits others have achieved or they may achieve. Regardless of whether a franchisor decides to include FPRs in its Item 19, the Franchise Rule requires the franchisor to begin its Item 19 disclosure with the following preamble:

The FTC's Franchise Rule permits a franchisor to provide information about the actual or potential financial performance of its franchised and/or franchisor-owned outlets, if there is a reasonable basis for the information, and if the information is included in the disclosure document. Financial performance information that differs from that included in Item 19 may be given only if: (1) a franchisor provides the actual records of an existing outlet you are considering buying; or (2) a franchisor supplements the information provided in this Item 19, for example, by providing information about possible performance at a particular location or under particular circumstances.<sup>153</sup>

Each franchisor has the right to determine the type of, if any, FPRs to include in Item 19 of its FDD. While the FTC considered imposing mandatory FPRs during its comment periods leading up to the adoption of the Franchise Rule, the FTC ultimately decided to leave the decision to include an FPR up to franchisors. As a compromise, however, the FTC mandated the inclusion of the preamble above to make clear to prospects that a franchisor could elect include FPRs in its FDD, assuming it had a reasonable basis for do so.

If a franchisor decides not to make an FPR, it is required under the Franchise Rule to insert the language below in its Item 19.

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.<sup>154</sup>

Other than the two exceptions referenced in the first preamble above and described at the end of this section, any FPR a franchisor wants to provide to a

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<sup>152</sup> 16 C.F.R. § 436.1(e) (emphasis added).

<sup>153</sup> 16 C.F.R. § 436.5(s)(1).

<sup>154</sup> 16 C.F.R. § 436.5(s)(2).

prospective franchisee must (1) meet the requirements and guidance of Item 19 of the Franchise Rule, the Compliance Guide, the FPR Commentary, and state law, and (2) be included in Item 19 of the franchisor's FDD.

If a franchisor chooses to include an FPR in Item 19 of its FDD, the Franchise Rule states that the franchisor must have a "reasonable basis" for the representation at the time the representation is made.<sup>155</sup> The Franchise Rule itself, however, provides little information as to what constitutes a "reasonable basis." The Compliance Guide states that "the quality and quantity of information constituting a reasonable basis [in support of an FPR] will vary from case to case," but that this information "must reasonably support the representation" and be "the sort of information upon which a prudent businessperson would rely on in making an investment decision."<sup>156</sup> To help fill the void and provide more guidance as to what is meant by a "reasonable basis," NASAA adopted the FPR Commentary in May 2017.<sup>157</sup>

Beyond the "reasonable basis" and "written substantiation" requirements, franchisors and their attorneys have a fair amount of latitude as to the form and content of their FPRs. FPRs can be based on historic information from franchised or company-owned outlets (subject to some limitations described below) or on projections. In addition, an FPR can be as simple as listing gross sales of a franchisor's one franchised outlet, to as complex as including a full profit and loss statement (P&L) for each of a franchisor's franchised and company-owned outlets. FPRs can also include other relevant industry-specific information like food and labor costs for restaurants, the number of members and average per member revenue for fitness concepts, or occupancy rates and average revenue per room (REVPAR) for hotel concepts. Accordingly, franchise attorneys find themselves preparing and reviewing more and more FPRs.

While FPRs can be based on either historical information of a system's outlets or projections (or forecasts) of future performance, the latter type of FPR is infrequently used and subject to even greater scrutiny than already exists for FPRs generally.<sup>158</sup> In addition, the FPR Commentary introduced further restrictions as to the content of projections (i.e., requiring they be based on historical data from the brand being offered), which even further reduces (or all but eliminates) when they may be used.<sup>159</sup> As a result, for purposes of efficiency and relevancy, the remainder of this section focuses on the requirements associated with FPRs based on historical data.

Under the Franchise Rule, a franchisor that makes a historic financial performance representation must state the material facts that underlie the representation. The Rule

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<sup>155</sup> 16 C.F.R. § 436.5(s)(3).

<sup>156</sup> Compliance Guide at 135.

<sup>157</sup> FPR Commentary.

<sup>158</sup> Franchisors must proceed cautiously with respect to including FPRs grounded in projections of future performance, as absent robust disclosure related to all elements of the projection (and why those elements support the franchisor's projection of future performance metrics to be attained by the prospective franchisee), a franchisor could find itself not only in violation of applicable federal and state disclosure requirements but perhaps also defending a variety of fraud and misrepresentation claims. See, Compliance Guide at 135-136 for additional detail on making reasonable projections of future performance.

<sup>159</sup> FPR Commentary at 19.19 and 19.20.

identifies six material basis elements that must each be addressed: (1) the group measured, whether it is all existing outlets or a subset that share particular characteristics, (2) time period measured in the sense of dates when the reported performance was achieved, (3) number of outlets that existed in the period of measurement and number with the characteristics of the group that was measured, (4) number of outlets with the described characteristics whose financial performance data were used in the representation, (5) number and percent of outlets that achieved the stated level of performance; and (6) distinguishing characteristics of the outlets that achieved the level of performance compared to characteristics of the franchise that the prospective franchisee may invest in.<sup>160</sup> The bullets below track the specific material facts listed in the Compliance Guide.<sup>161</sup>

- Group Measured.<sup>162</sup> A franchisor that makes an historic financial performance representation, in Item 19 must state whether the representation relates to the performance of all its existing outlets or only a subset of them sharing some characteristic. Further, the FPR must clearly identify if it is based on franchised outlets, company-owned outlets (which include outlets owned by an affiliate), or both. While a franchisor may base an FPR “on data from fewer outlets than are in the entire system if these outlets share one or more characteristics in common,” it may only do so if the use of the smaller grouping of outlets has a “reasonable basis.”<sup>163</sup>

For example, for the most part, a franchisor making an FPR that includes data from both franchise outlets and company-owned outlets must disclose the data from each category of outlets separately.<sup>164</sup> However, a franchisor that separately discloses franchised outlets and company-owned outlets in an FPR may then elect to present the same data in a combined format.<sup>165</sup> In addition, “if a franchisor has such a small number of total franchisees that the identity of franchisee(s) whose data is being reported in Item 19 is discernible [presumably less than 10 franchisees], and the franchise and company-owned outlets have gross sales that are not materially different, the franchisor may merge the data in the FPR.”<sup>166</sup>

Further, once a franchisor has at least one “operational franchise outlet” (a franchised outlet that has been open for one full year or one full season, in the case of a seasonal franchise system), the franchisor may not make an FPR based on gross sales data from company-owned outlets alone.<sup>167</sup> In addition, in those cases where a franchisor is permitted to include gross sales or gross profit or net profits data of company-owned outlets in an FPR, the franchisor also must include additional information or adjustments to reflect all actual and

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<sup>160</sup> 16 C.F.R. § 436.5(s)(3).

<sup>161</sup> See generally, Compliance Guide at 87-91. For additional information regarding necessary disclosures related to projections of future performance, see *Id.* at 91-92 and 135-136.

<sup>162</sup> Compliance Guide at 87.

<sup>163</sup> *Id.* at 87.

<sup>164</sup> FPR Commentary at 19.11.

<sup>165</sup> *Id.*

<sup>166</sup> *Id.*

<sup>167</sup> *Id.* at 19.8.

reasonably expected differences between company-owned outlets and operational franchise outlets.<sup>168</sup>

The FPR Commentary also establishes limitations as to the use of certain subsets. For example, a franchisor may not include a subset of its best performing outlets in an FPR without including the corresponding lowest performing outlets, even if the FPR also discloses system-wide performance information for all outlets.<sup>169</sup> It is also presumed that a franchisor with less than 10 substantially similar company-owned outlets and franchise operational outlets as of the end of its last fiscal year has too few outlets to make an FPR based on a subset of those outlets.<sup>170</sup>

- Time Period Involved.<sup>171</sup> The Compliance Guide calls for disclosure when the stated level of performance was achieved. As such, franchisors must ensure that the time period measured is relevant in light of facts and circumstances present at the time the FPR is made.
- Number of Outlets Measured.<sup>172</sup> The Compliance Guide calls for disclosure of how many outlets are in the group that achieved the stated level of performance, and how many are in the entire system.
- Number of Outlets Reporting.<sup>173</sup> The Compliance Guide asks how many outlets in the relevant group supplied the performance data underlying the representation -- i.e., disclosure of the total number of franchisees within the group being measured for the FPR as compared to the number of franchisees that actually reported.
- Number and Percentage of Outlets that Achieved the State Level of Performance.<sup>174</sup> Disclosure of the number and percentage of outlets that achieved the stated performance -- This ensures that prospective franchisees easily can identify whether the stated performance level (average gross sales, for example) was achieved by a majority of the franchised outlets or whether one or two high volume locations skewed the average. Building on these requirements, the FPR Commentary also clarifies that that a franchisor cannot include an average in an FPR without including the corresponding median, and vice versa.<sup>175</sup> The rationale is that including one without the other may be misleading (even if the calculation is accurate). In addition, whenever a

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<sup>168</sup> *Id.* at 19.9 and 19.10.

<sup>169</sup> *Id.* at 19.13.

<sup>170</sup> *Id.* at 19.14.

<sup>171</sup> Compliance Guide at 88.

<sup>172</sup> *Id.* at 89

<sup>173</sup> *Id.*

<sup>174</sup> *Id.* at 90.

<sup>175</sup> FPR Commentary at 19.16 and 19.17.

franchisor discloses average and median gross sales, it also must disclose the highest and lowest numbers in the range for both.<sup>176</sup>

- Distinguishing Characteristics.<sup>177</sup> This is the catch-all requiring franchisors to identify any other material information, which if known, would add or retract from the likelihood that a prospective franchisee might achieve similar performance to that stated in Item 19.

Similarly, a forecast of future performance must also include information on the material bases and assumptions of the projection. These include stating significant factors on which the franchisees future results will depend. Examples stated in the rule include economic or market conditions that will impact the franchisee's operations, sales, costs of goods or services and operating expenses.

Franchisors that make FPRs in Item 19 must provide written substantiation of the statement to prospective franchisees upon reasonable request.<sup>178</sup> Within this context, a prospective franchisee's request is considered reasonable if it "gives the franchisor sufficient time to produce the substantiation at a convenient location, possibly at company-owned headquarters or where the substantiation is stored if it contains confidential information or is voluminous."<sup>179</sup> While all franchisors are subject to requests for material substantiation from prospectively franchisees, our experience is that franchisors rarely receive such requests.

While franchisors are required to include an "admonition" in Item 19 that warns prospective franchisees that their performance may differ from the stated level,<sup>180</sup> a franchisor is prohibited from including any other disclaimers that arguably negate a prospective franchisee's ability to rely on the information presented. In fact, under the FPR Commentary, the following are the only permitted disclaimers, which must be presented in a separate paragraph from the rest of the FPR and must be in bold type<sup>181</sup>:

- 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."**<sup>182</sup>

Two primary exceptions to including a representation in Item 19 are described below.

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<sup>176</sup> *Id.*

<sup>177</sup> Compliance Guide at 90.

<sup>178</sup> 16 C.F.R. § 436.5(s)(3)(v).

<sup>179</sup> Compliance Guide at 92-93.

<sup>180</sup> 16 C.F.R. § 436.5(s)(3)(iv); FPR Commentary at 19.3.

<sup>181</sup> FPR Commentary at 19.22.

<sup>182</sup> FPR Commentary at 19.3.

Actual Operating Results of Outlet Being Offered for Sale. A franchisor is permitted to provide a prospective franchisee the actual operating results of a particular outlet the prospective franchisee is interested in purchasing, even though this information is not included in the franchisor's FDD.<sup>183</sup> This execution, however, is only available to prospects that are legitimately interested in purchasing the outlet. For example, the franchisor cannot provide the actual operating results of a franchised outlet for sale in Florida to a prospect in the state of Washington, if the Washington prospect has no real desire to purchase the Florida outlet.

Supplemental FPR. If a franchisor includes an FPR in Item 19 of its FDD, it may also provide to a prospective franchisee a supplemental FPR, outside of the FDD, about "a particular location or variation" relating to the franchise being offered to the prospective franchisee.<sup>184</sup> For example, if a franchisor's FPR in Item 19 includes average gross sales of all franchised outlets across the country, the franchisor may want to provide a supplemental FPR containing average gross sales of only those franchised outlets in Washington D.C., Maryland, and Virginia, if the prospective franchisee desires to purchase a franchise to be located in D.C. area. A supplemental FPR must be in writing, explain how it is a departure from the FPR in the FDD, and be prepared in accordance with the other requirements of Item 19. We advise against a franchisor introducing new categories of information in its supplemental FPR.

Finally, on June 10, 2020, NASAA issued new guidelines about Disclosing Financial Performance Representations in the Time of COVID-19, which can be found at <https://www.nasaa.org/wp-content/uploads/2020/06/FPRs-in-the-time-of-COVID-19.pdf>. As noted by NASAA, "[a]lthough franchising has weathered other economic upheavals and natural disasters in the past, the COVID-19 pandemic's impact on franchise systems appears to be unprecedented."<sup>185</sup> While franchisors all over the United States have certainly been affected in some way by the COVID-19 pandemic, not all franchisors and not all franchise businesses have been affected equally. These changes will likely continue and may even become permanent, even in a post-COVID world. Franchisors that include in Item 19 a financial performance representation based on historical data should continue to seek counsel especially as to whether the information presented is representative of what prospective franchisees can expect as a consequence of COVID-19.

## **21. Item 20: Outlets and Franchisee Information**

Item 20 requires disclosure of how the franchise system has changed annually over the past three fiscal years. Included in Item 20 are five separate tables that provide details related to the following: (1) systemwide outlet summary of franchised and company-owned outlets for the past three fiscal years, (2) transfers of outlets for the past

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<sup>183</sup> 16 C.F.R. § 436.5(s)(4); Compliance Guide at 93.

<sup>184</sup> 16 C.F.R. § 436.5(s)(5); Compliance Guide at 93.

<sup>185</sup> NASAA, *NASAA New Franchise State Cover Sheets Instructions*, (May 19, 2019), <https://www.nasaa.org/wp-content/uploads/2020/06/FPRs-in-the-time-of-COVID-19.pdf> (last visited April 24, 2022).

three fiscal years, (3) status of franchised outlets for the past three fiscal years (i.e., number of outlets at the beginning of the year, outlets opened, outlets terminated, outlets not renewed for additional term, outlets reacquired by the franchisor, outlets that ceased operations for other reasons, and total outlets at the end of the year), (4) status of company-owned outlets for the past three fiscal years, and (5) projected openings of franchised outlets and company-owned outlets in the next fiscal year and franchise agreements signed but outlets not opened.<sup>186</sup>

A franchisor must provide contact information for current and former franchisees (usually included as an exhibit to the FDD), and along with the former franchisee information, must include the following statement: “If you buy this franchise, your contact information may be disclosed to other buyers when you leave the franchise system.”<sup>187</sup> Either in these lists or elsewhere in Item 20, the franchisor also must disclose whether any franchisees have signed confidentiality agreements within the last three fiscal years that restrict their ability to speak about the franchised business and their related experiences.<sup>188</sup>

If a franchisor has created, sponsored, or endorsed a franchisee organization associated with the franchise system, the franchisor must disclose in Item 20 contact information for this organization and the franchisor’s relationship to it.<sup>189</sup> In addition, if a franchisor’s franchisees form an independent franchisee organization (or association), the franchisor must include contact information for this organization in Item 20, provided it is properly organized under state law and sends to the franchisor a written request for inclusion its FDD within 60 after the close of the franchisor’s fiscal year end.<sup>190</sup>

## **22. Item 21: Financial Statements**

Item 21 requires disclosure of a franchisor’s financial statements. The financial statements must be presented in a tabular format that compares at least two fiscal years and includes: (1) the franchisor’s balance sheet for the previous two fiscal year ends; and (2) statements of operations, stockholders equity, and cash flows for each of the franchisor’s previous three fiscal years.<sup>191</sup> The financial statements must be audited in accordance with United States generally accepted auditing standards (“GAAS”) and to be presented in accordance with United States generally accepted accounting principles (“GAAP”).<sup>192</sup> A franchisor must include audited financial statements of its parent (along with a signed guaranty) if the parent of the franchisor commits to provide post-sale obligations of the franchisor or guarantee the franchisor’s obligations.<sup>193</sup> A franchisor also is obligated to include audited financial statements of its parent if that parent is the “sole supplier of a good or service without which a franchise cannot be operated.”<sup>194</sup> In lieu of

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<sup>186</sup> 16 C.F.R. § 436.5(t).

<sup>187</sup> 16 C.F.R. § 436.5(t)(4) and (5).

<sup>188</sup> 16 C.F.R. §436.5(t)(7).

<sup>189</sup> 16 C.F.R. §436.5(t)(8)(i).

<sup>190</sup> 16 C.F.R. §436.5(t)(8)(ii).

<sup>191</sup> 16 C.F.R. §436.5(u)(1).

<sup>192</sup> *Id.*

<sup>193</sup> 16 C.F.R. §436.5(u)(1); Compliance Guide at 114.

<sup>194</sup> FTC FAQ #30.

its own financial statements, a franchisor may include the audited financial statements of one of its affiliates, provided the statements meet the requirements of Item 21, the affiliate guaranties the franchisor's obligations, and the signed guaranty is included in the FDD.<sup>195</sup>

Under the Franchise Rule, franchisors that are new to franchising and do not yet have audited financial statements may phase-in the use of audited financials over a three-year period.<sup>196</sup> The new franchisor begins year one with an "opening" unaudited balance sheet as of the date the franchisor commences franchising activities. In year two, the franchisor must provide in Item 21 an audited balance sheet as of the end of the franchisor's first partial or full fiscal year selling franchises. In year three, the franchisor provides another full suite of audited financials.<sup>197</sup> It is important to note that this phase-in option is only permitted for unaffiliated entities that are completely new to franchising and not for "spin-off" franchises from existing franchisor entities.<sup>198</sup> As further described in Section II.C.1.e, Minnesota, New York, and Virginia do not allow for the phase-in of audited financial statements.

### **23. Item 22: Contracts**

The Franchise Rule requires a franchisor to list in Item 22 and attach as an exhibit to the FDD "all proposed agreements regarding the franchise offering, including the franchise agreement and any lease, options, and purchase agreements."<sup>199</sup> Actual samples of each of these agreements must be included as exhibits to the FDD.

### **24. Item 23: Receipts**

Item 23 will reference the receipt pages, which are attached to the end of the FDD, either as the last exhibit or as stand-alone documents. The detail that appears on the receipt pages is specific and must be adhered to closely.

The receipt pages attached to the end of the FDD inform the prospective franchisee of important information and rights under federal and state law, as well as contain the date the prospective franchisee was disclosed with a specific FDD, the date the FDD was issued, and a list of all exhibits they should have received in connection with the FDD.<sup>200</sup> The Franchise Rule requires the prospective franchisee to identify all "franchise sellers" that were involved in the offer and sale of their particular franchise and places the burden on the franchisor to ensure the franchise seller is properly identified.<sup>201</sup> It is a fairly common practice among franchisors (and is required by some state examiners) to specifically identify on the receipt pages those franchise sellers that will be involved in all franchise sales and leave blanks for any other franchise sellers who may

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<sup>195</sup> 16 C.F.R. §436.5(u)(1)(iii).

<sup>196</sup> 16 C.F.R. §436.5(u)(2).

<sup>197</sup> *Id.*

<sup>198</sup> Compliance Guide at 115.

<sup>199</sup> 16 C.F.R. §436.5(v).

<sup>200</sup> 16 C.F.R. §436.5(w).

<sup>201</sup> 16 C.F.R. §436.5(w)(2); Compliance Guide at 118.



be significantly involved in a particular sale.<sup>202</sup> Franchisors then provide to prospective franchisees before they sign a franchise agreement an updated receipt page with information for any additional franchise sellers. Finally, and importantly for the franchisor's records, the receipt pages must contain instructions for the prospective franchisee to sign both receipt pages and then return one of them to the franchisor.<sup>203</sup>

### **C. State-Specific Disclosure Requirements**

The Franchise Rule provides the minimum disclosure requirements that apply to all franchise offerings. However, the Registration States may impose additional requirements, and if a franchisor desires to offer or sell franchises into a state that regulates franchising, the franchisor must comply with any additional state-specific disclosure requirements that apply to that offer or sale. These state-specific disclosures are typically included in the state-specific addenda to the FDD.

The laws of more than one state may apply to a single offer and sale of a franchise depending on which state or states an "offer" or "sale" is deemed to have occurred. Although the laws of the various Registration States differ, whether or not the events listed below occurred within the state are often key factors in making this determination.

- Meetings between the franchisor and prospective franchisee at which the parties have substantive communications about the franchise opportunity.
- The offer to sell a franchise originates in the state (e.g., from the franchisor's headquarters in the state).<sup>204</sup>
- The offer to sell a franchise is directed by the franchisor to the state and received by the prospective franchisee in the state where it is directed.
- The prospective franchisee accepts the offer to buy the franchise in the state.
- The offer or sale is made to a franchisee who is domiciled in the state. Under some state laws, the franchisee's domicile in the state is enough. Under other state laws, the franchisee must be a domiciliary and operate the franchised business in the state.

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<sup>202</sup> FTC FAQs #12 and #23.

<sup>203</sup> 16 C.F.R. §436.5(w)(8).

<sup>204</sup> California, Hawaii, Illinois, Maryland, Michigan, Minnesota, Rhode Island, South Dakota, Virginia and Wisconsin each provide an exemption from registration for, or simply do not cover, "out-of-state" sales. These are sales made by a franchisor headquartered in one of these Registration States to an out-of-state prospective franchisee who neither resides nor will operate the franchised business in the same state as the franchisor's headquarters. The out-of-state sales exemption allows a franchisor to have its principal place of business in a Registration State without having to register to sell franchises there as long as: (1) all sales activities are with a non-resident who will operate franchises in a different state, and (2) the franchisor complies with the Franchise Rule and all other state franchise sales laws that apply to the transaction.

- The offer or sale is made to a franchisee who resides in the state. Like domicile, in some states the franchisee's residence in the state is enough; in other states the franchisee must be a resident and operate the franchised business in the state.
- The franchised business will be operated in the state or any portion of the franchise territory is in the state.
- The franchise contemplates or requires the franchisee to establish or maintain a place of business in the state.

In addition to complying with the state-specific disclosure requirements described below in this Section II.C, a franchisor must also ensure that its sales activities do not inadvertently cause the state franchise laws to apply in a state where the franchisor is not registered. The registration requirements for the various states are addressed below in Section III.

### **1. Examples of Additional State-Specific Disclosures**

This Section II.C.1 summarizes some common additional state-specific disclosures.

#### **a. Item 1: Laws & Regulations**

As noted in Section II.B.2 above, the Franchise Rule requires franchisors to summarize for prospective franchisees any laws and regulations applicable to the franchised business. While there are a number of federal laws that apply to businesses generally that a franchisor will reference in its Item 1 disclosure, depending on the nature of the franchised business and the states in which the franchise will be offered, additional state-specific laws, regulations, and/or licensing requirements may need to be disclosed.

#### **b. Item 4: Bankruptcy**

As noted in Section II.B.5 above, the Franchise Rule requires franchisors to disclose bankruptcy and related proceedings that have occurred in the prior 10 years. Minnesota, however, requires an additional bankruptcy disclosure. Under Minnesota law, the bankruptcy disclosure is 15 years.<sup>205</sup> The unknowing franchisor who deletes a bankruptcy disclosure after ten years will be opening itself up to liability from those Minnesota franchisees who purchased franchises during the five-year period after deletion of the disclosure.

#### **c. Item 8: Rebates**

As summarized in Section II.B.9 above, the Franchise Rule requires a franchisor to make certain disclosures related to any obligatory purchases, sourcing restrictions, and

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<sup>205</sup> Minn. R. 2860.3500(4)(D).

rebates received from suppliers. The Maryland regulations require franchisors to take these disclosures a few steps further. Specifically, the Maryland regulations require the following additional detail: (1) a disclosure of any affiliation between the franchisor and these sources of supply; (2) if the source is affiliated with the franchisor, the cost to the seller of the items; (3) the prevailing market price for the goods, and if none exists, an explanation as to why the market price cannot be determined; and (4) the manner, if any, in which the franchisor or its affiliate under the terms of the franchise agreement ensures the availability of the goods.<sup>206</sup>

#### **d. Item 11: Advertising**

In addition to the Item 11 advertising fund disclosures required under the Franchise Rule, the Maryland regulations also require franchisors to disclose: (1) how fees related to advertising are to be raised or spent; and (2) how a franchisee may obtain an accounting of the advertising expenditures.<sup>207</sup>

#### **e. Item 21: Financial Statements**

As described in Section II.A.22 above, the Franchise Rule permits franchisors that are new to franchising to “phase in” the use of audited financial statements over a three-year period and specifically allows for the use of an unaudited opening balance sheet during year one. The use of an unaudited opening balance sheet to satisfy the Item 21 disclosure requirement is not, however, permissible under certain state franchise acts. Specifically, Minnesota, New York, and Virginia require that a franchisor have its opening balance sheet audited by a certified public accountant.<sup>208</sup>

### **2. State Cover Page and Risk Factors; NASAA Proposal**

As noted above, various state laws and state administrators may require additional disclosures be included in the FDD. These disclosures can be presented in the body of the FDD or in a state-specific addendum to the FDD.<sup>209</sup> State administrators often request that a franchisor include certain state-specific risk factors into a “state cover page” that is included immediately after the federal cover page described above in Section II.B.1. Typically, the inclusion of particular risk factors is based upon: (1) the state in which the franchise is being offered, (2) the dispute resolution provision selected by the franchisor, (3) whether minimum performance obligations are imposed, (4) whether any conditions are imposed on the owner’s spouse, and (5) the financial condition and experience of the franchisor. At this point, state administrators have not adopted uniform risk factors or a uniform approach for when a particular risk factor will be required. As a result, a franchisor should not include any risk factor on its state cover page that is not required under the Franchise Rule or state law, or by a state administrator. Some of the risk factors commonly imposed by state administrators are included on Exhibit D. It appears,

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<sup>206</sup> Md. Code Regs. 02.02.08.16(J).

<sup>207</sup> Md. Code Regs. 02.02.08.16(G).

<sup>208</sup> Minn. Stat. Ann. § 80C.04; N.Y. Comp. Codes R. & Regs. tit. 13, § 200.2; 21 Va. Admin. Code 5-110-55.

<sup>209</sup> Compliance Guide at 26.

however, that changes to the state cover page and risk factors are coming soon that will likely provide more uniformity.

### **3. State Addenda**

As described above, every franchisor must comply with the specific disclosure requirements of each state in which the franchisor wishes to offer and sell franchises. However, this does not mean the franchisor must prepare a separate, state-specific FDD to address the requirements of each state. Instead, most franchisors prepare state-specific addenda to address: (1) disclosures required to advise prospects of that state's limited review of the franchisor's FDD; and (2) modifications to the FDD (and to related agreements) that are necessary to (a) notify the franchisee of its rights under that state's franchise relationship laws such as the franchisee's rights in connection with termination and non-renewal of the franchise agreement, (b) preserve the franchisee's rights under state law from waiver or modification by the terms of the franchise or other agreement, and (c) disclose any financial assurances the franchisor is required to provide as a condition of registration due to the franchisor's financial condition and/or years of franchising experience.<sup>210</sup>

Examples of state addenda are attached as Exhibit E. Certain states also require the binding agreements to be amended to reflect the same disclosures that are reflected in the state-specific addenda. The state-specific amendments that modify the terms of these agreements are typically included with the agreements in Item 22.

### **4. State-Specific Timing Requirements**

In addition to the state-specific disclosure issues described above, Connecticut, Michigan, New York, Iowa, and Maine impose different timing requirements for the franchisor to provide its FDD to prospects. Connecticut and Michigan require franchisors to provide the disclosure document to prospective franchisees at least 10 business days before prospects sign a binding agreement with, or make a payment to, the franchisor or an affiliate in connection with the proposed franchise sale.<sup>211</sup> New York requires franchisors to provide the disclosure document to prospective franchisees at the earlier of the first personal meeting or 10 business days before prospective franchisees sign a binding agreement with, or make a payment to, the franchisor or an affiliate in connection with the proposed franchise sale.<sup>212</sup> Iowa requires franchisors to provide the disclosure document to prospective franchisees at the earlier of the first personal meeting or 14 days

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<sup>210</sup> Depending on the franchisor's financial condition and years of franchise experience, a state may require a franchisor to provide financial assurances as a condition of registration. The specific financial assurance required varies by state, but typically a franchisor may satisfy the financial assurance by either: (1) deferring collection of the initial franchise fee (and all other initial fees) until the franchisor satisfies its pre-opening obligations and the franchisee commences operation, (2) escrowing payment of the initial fees, (3) posting of a surety bond, or (4) providing a guaranty of the franchisor's obligations to its franchisees from a parent or affiliate of the franchisor and attaching a copy of the audited financial statements of the guarantor to the FDD.

<sup>211</sup> Conn. Gen. Statutes, § 36B-63(a); Mich. Comp. Laws Ann. §445.1508.

<sup>212</sup> N.Y. Gen. Bus. Law § 683(8)(a).

before prospective franchisees sign a binding agreement with, or make a payment to, the franchisor or an affiliate in connection with the proposed franchise sale.<sup>213</sup>

### **III. State Franchise Registration**

The Franchise Rule has no separate registration requirement; it is a disclosure rule only. Once an FDD has been prepared in accordance with the disclosure guidelines above, it can be used immediately in all states governed by the Franchise Rule only. On the other hand, the Registration States require both registration and disclosure. Before offering or selling franchises in the applicable state, a franchisor must submit for, and in 10 cases receive approval of, a franchise registration. Failure to secure the franchise registration prior to offering or selling a franchise subject to the state's law can result in penalties for the franchisor.

Although registration must be secured before an offer or sale, the states' review of the FDD (if applicable) does not include any evaluation of the franchise offer itself. The review is limited to confirmation that the FDD has been prepared in accordance with all applicable disclosure requirements (including the Franchise Rule, Compliance Guide, FTC Amended Rule FAQs, NASAA Guidelines, NASAA Commentary, and applicable state law and that all required registration materials have been submitted.

#### **A. State Registration Filing Requirements**

Similar to the varying disclosure obligations, the Registration States have varying requirements for the materials that must be submitted in order to obtain registration. In addition to the FDD, states can require various forms specified by the NASAA Guidelines and/or state law to be submitted. The typical forms include a franchise registration application facing page (which requires a franchisor to provide basic information and specify the type of filing), a certification page (which requires a franchisor's representative to certify the information submitted is true and accurate), a consent to service of process (which requires a franchisor to authorize a state agency to provide service in connection with franchise issues), franchise seller disclosure forms (which disclose information about the individuals who offer and sell franchises on the franchisor's behalf), franchisor's costs and source of funds (which requires franchisors to estimate their out-of-pocket costs to open each franchised location), and an auditors' consent letter (authorizing a franchisor to include the audited financial statements in the FDD). Some states also require other materials to be submitted, such as information regarding sales activity during the preceding fiscal year, certification that all applicable taxes in the state have been paid or a franchise broker registration for third-party franchise sellers.

The means by which a franchisor may submit its application to a state varies and has evolved over the course of the last few years. While the majority of states previously required that a franchisor submit its franchise registration via hard copy, the majority now require either that the filing be submitted online or on CD-ROM. In addition, NASAA has also developed its own online filing system which many states have chosen to have as

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<sup>213</sup> Iowa Code Ann. § 551A.4;

an option for franchisors. Exhibit F provides the current requirements for each of the types of filings (initial, renewal, and amendment) in each of the states. Note that the filing requirements may be different for franchisors that qualify for exemptions, as further described in Section IV.

## **B. State Review and Comment Process**

Once a franchisor has submitted its complete application, many of the state franchise laws and regulations provide the examiner with a statutorily defined period within which the application must be reviewed and either approved or denied. Failure to complete the review within the specified period will result in the registration application being automatically approved unless the state issues a stop order or a comment or deficiency letter. If applicable, the comment or deficiency letter will describe the corrections or additions that must be addressed in order to obtain registration. As described above, these comments generally relate only to failures to comply with the applicable disclosure requirements, but can also relate to failures to submit required documents and/or other state-imposed requirements in order to obtain registration (e.g. financial assurance conditions). States vary in the degree to which the FDD is reviewed, with some states reviewing the application and FDD only to ensure all required documentation is included (in essence, a notice filing) while others engage in wholesale review of the application, including the FDD to ensure compliance.

The “notice filing” states are Indiana, Michigan, South Dakota, and Wisconsin. In these states, once the complete application is received, the registration will be made effective immediately. Administrators in these states are authorized by statute to review the materials submitted in the filing, including the FDD, but typically do not do so or, if they do, look at a very limited scope of issues (e.g. the franchisors financial condition).

There are also business opportunity laws in Florida, Kentucky, Nebraska, Texas, and Utah that apply to franchise programs.<sup>214</sup> In each of these states, franchisors may obtain an exemption from the business opportunity law by simply filing a form and, in some cases, paying a fee (and complying with the federal franchise disclosure law). The Kentucky, Nebraska and Texas exemptions were one-time filings (i.e. once the filing has been submitted, the exemption is perpetually in place) and the Florida and Utah exemptions are renewed annually.

In the remaining Registration States (California, Hawaii, Illinois, Maryland, Minnesota, New York, North Dakota, Rhode Island, Virginia, and Washington), examiners will conduct a review of all materials submitted and must issue an approval before a franchisor may offer or sell in the state. If the examiner identifies any deficiencies in the FDD or the application materials, he or she will issue a comment letter highlighting the

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<sup>214</sup> There are other business opportunity law states that exempt from the definition of a “business opportunity” a franchise that licenses a federally (or state) registered mark or franchise offerings that comply with the Franchise Rule. Franchisors that do not meet the requirements may be required to submit business opportunity registration filings. These filings have similar requirements as franchise registration filings, but are not covered in detail in this paper.

issues that must be addressed by the franchisor in order for an approval to be granted. The issues may require the franchisor to provide additional information and/or revise the FDD to address the comments. State administrators may issue additional comment letters if a franchisor's responses do not sufficiently address their comments.

### **C. Recommendations for an Efficient Registration Process**

Some state issue their own recommendations for ways to expedite the registration process, but below are some general recommendations for ensuring the process is efficient:

- Before submitting, review the FDD complies with the Franchise Rule, Compliance Guide, Amended Franchise Rule FAQs, and NASAA Guidelines and Commentary, and applicable state law;
- Ensure compliance with applicable state law by including, where applicable, state amendments to the FDD;
- Comply with all state filing requirements in Exhibit F for all types of filings;
- Review all information included the FDD, including cross checking information that is repeated in multiple items of the FDD (e.g. the number of franchised locations which may be included in Items 19 and 20);
- Confirm that financial statements included in the FDD conform to the requirements under applicable law and are consistent with the disclosures in the FDD (e.g. total number of franchised locations);
- Confirm that all forms and supplemental registration materials confirm to state requirements;
- Thoroughly review any comment and deficiency letters and respond to all comments with complete responses;
- Contact state examiners with any questions about comments that are unclear or which the franchisor believes are inaccurate;
- Provide all materials required by the state examiners for responses tom comment letter (e.g. redlined copies of the revised pages only or of the entire FDD); and
- File a single response that adequately addresses to all comments.

It is also important to maintain a current record of a franchisor's status in each registration state, including effective and expiration dates. Franchise sellers will need to refer to the record to determine whether offers or sales can be directed to prospects in

that state. The record can also include any special conditions that may be relevant for a particular state (e.g. financial assurance conditions or state-specific versions of the FDD).

#### **IV. Franchise Amendment and Renewal Requirements**

Under the Franchise Rule, a franchisor is required to maintain an up-to-date FDD. Specifically, a franchisor is required to update the FDD at least annually, but is also required to update the FDD on a quarterly basis if there are material changes in the information included the FDD throughout the course of the year. The Registration states also require annual filings and amendment filings, and some states require that amendments be filed within a specified time period after the occurrence of a material change.

##### **A. When is an Amendment Necessary?**

###### **1. Federal Requirements**

The Franchise Rule requires amendments to be prepared on a quarterly basis. Within a reasonable time after the close of each quarter, a franchise must revise the FDD to reflect any “material changes.”<sup>215</sup> The revisions can be made either by changing the disclosures within the FDD itself or by preparing a supplement to the FDD which is also disclosed to the prospective franchisee. A “material change” is one that is likely to affect a prospective franchisee’s investment decision, and should be viewed through the lens of a prospective franchisee.<sup>216</sup> The Compliance Guide and applicable state law define certain events or changes that qualify as material (e.g. new legal actions being filed against the franchisor or the closing of a significant number of outlets), but do not provide exhaustive lists of the types of changes that necessitate an amendment.<sup>217</sup> Accordingly, franchisors need to be monitoring events and changes that affect the disclosures in the FDD to determine, on an ongoing basis, whether an amendment is necessary.

Notwithstanding the ongoing obligation to amend the FDD upon the occurrence of a material change, there are certain disclosures in the FDD that require updating on an annual basis only. For example, franchisor-initiated litigation disclosures in Item 3 must be updated only once a year.<sup>218</sup> Likewise, the statistical information contained in the Item 20 table about franchised and company-owned outlets, as well as the lists of current and former franchisees, need only be revised on an annual basis. In addition, any financial information required to be audited need not be re-audited for a quarterly update, unless there is a material change affecting the previously audited financial information – and, in that case, a franchisor may furnish unaudited information in the quarterly update.<sup>219</sup>

An important exception to the Franchise Rule’s quarterly amendment requirement is that a franchise seller, when furnishing an FDD, must notify the prospective franchisee

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<sup>215</sup> 16 C.F.R. §436.7(b).

<sup>216</sup> Statement of Basis and Purpose, 72 Fed. Reg. 15444, 15455, 15482 (Mar. 30, 2007).

<sup>217</sup> Compliance Guide at 126.

<sup>218</sup> *Id.*

<sup>219</sup> *Id.* at 126-27.



of any material changes that the seller knows or should have known occurred with respect to any FPR made in Item 19.<sup>220</sup> This obligation arises even if a disclosure document is furnished at a time that falls between quarterly updates.

## 2. State Requirements

There are also amendment requirements under applicable law in California, Hawaii, Illinois, Maryland, Minnesota, New York, North Dakota, Rhode Island, Virginia, Washington and Wisconsin. While the Franchise Rule provides that amendments need only be prepared on a quarterly basis, most state laws require amendments to be prepared more quickly. In California, Maryland, Michigan, New York, North Dakota, and Rhode Island, the FDD must be updated and an amendment must be filed “promptly” after the occurrence of a material change.<sup>221</sup> In Hawaii, Virginia, and Washington, the amendment must be prepared “upon the occurrence” of a material change.<sup>222</sup> In Minnesota and Wisconsin, the amendment to the FDD must occur within 30 days after a material change.<sup>223</sup> Illinois follows the same quarterly timeline as required by the Franchise Rule.<sup>224</sup> Indiana does not require a franchisor to file a formal amendment for a material change, but a franchisor can upload its amended FDD using the securities portal any time there is an amendment.<sup>225</sup> Michigan and South Dakota do not require amendments to the FDD to be filed. Understanding when an amendment must be filed in the Registration States requires franchisors to maintain accurate records of the effective registrations and actively monitor changes to the franchise system that may necessitate filings under applicable state laws.

### B. Annual Renewal Requirements

Besides the amendment obligations described above, state and federal law requires franchisors to prepare an updated FDD annually. The annual updating requirements under both the Franchise Rule and state laws are discussed below.

#### 1. Federal Requirements

Under the Franchise Rule, a franchisor must update the information in its FDD within 120 days after its fiscal year end.<sup>226</sup> After a revised FDD has been prepared, a franchisor may only distribute the revised FDD and no other disclosure document.<sup>227</sup> After the 120-days period has elapsed, if a franchisor has not prepared an updated FDD, it must cease offering and selling franchises until a new FDD has been prepared.<sup>228</sup>

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<sup>220</sup> 16 C.F.R. §436.7(d); Compliance Guide at 126.

<sup>221</sup> Cal. Corp. Code § 31123, Md. Code Ann., Bus. Reg. § 14-220, Mich. Comp. Laws Ann. § 445.1519, N.Y. Gen. Bus. Law § 683, N.D. Cent. Code Ann. § 51-19-07, 19 R.I. Gen. Laws Ann. § 19-28.1-11.

<sup>222</sup> Haw. Rev. Stat. Ann. § 482E-3, 21, Va. Admin. Code 5-110-40, Wash. Rev. Code Ann. § 19.100.070.

<sup>223</sup> Minn. Stat. Ann. § 80C.07, Wis. Stat. Ann. § 553.31.

<sup>224</sup> 815 Ill. Comp. Stat. Ann. 705/11, S.D. Codified Laws § 37-5B-7.

<sup>225</sup> Ind. Office of the Sec’y of State Secs. Div., *Order Regarding Franchise Registrations by Notification*, Order No. 01-0109 AO, Bus. Franchise Guide (CCH) ¶ 5,140.012 (June 4, 2001).

<sup>226</sup> 16 C.F.R. § 436.7(a).

<sup>227</sup> *Id.*

<sup>228</sup> *Id.*

Because all information in the FDD must be updated during the annual renewal process, many franchisors make changes to their franchise offering during this period. By doing so, franchisors avoid the cost of filing post-effective amendments with states and interrupting any pending franchise sales currently in process. The annual updating requirements require an analysis of potential changes to all information in the FDD, but there are several disclosures items that must be updated (e.g. franchisor and affiliate revenue disclosures in Item 8, advertising fund expenditures in Item 11, Item 20 unit counts and lists of current and former franchisees, and financial statements).

## **2. State Requirements**

Similar to the Franchise Rule, the Registration States require a franchisor to update the FDD and submit a registration renewal application on an annual basis. The timing for the renewal filing varies by state, but must be made either within 90 or 120 days of the franchisor's fiscal year end or prior to the anniversary of the effective date of the previous registration. The expiration date of the registration will typically be communicated by the state in the letter granting registration. Certain registration states that grant registration periods that are not tied to the franchisor's fiscal year end require that the franchisor submit its registration renewal filing at least a certain number of days before the expiration of the current registration (e.g. 15 business days in Maryland and 30 calendar days in Rhode Island and Virginia). Similar to initial filings, the timing of when renewal filings become effective in the states also varies. In California, Maryland, Minnesota, New York, North Dakota, Rhode Island, Virginia<sup>229</sup> and Washington, franchisors must wait to receive approval of the renewal filing before continuing offer and sales activity using the updated FDD. On the other hand, the filings in Illinois, Indiana, Michigan, South Dakota, and Wisconsin are automatically effective upon receipt by the state. In Hawaii, unless the examiner issues a comment letter, the renewal filing is deemed automatically effective 7 calendar days after receipt by the state.

Failure to file a renewal application in a timely manner can result in a franchisor having to cease all offering and sales activity in, and re-file an initial application with, the applicable state. In some states, the only difference between a renewal filing that was timely submitted and one that was submitted late will be the filing fee. Other some states may engage in a lengthier review of the FDD if the renewal filing deadline is missed, resulting in a longer period within which a franchisor must cease offering and selling franchises in that state.

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<sup>229</sup> In Virginia, franchisors meeting certain criteria may submit an "affidavit of compliance" which allows for the filing to become automatically effective upon receipt by the state.

## **C. Re-Disclosure Requirements and Permitted Activities While Renewal or Amendment Applications are Pending**

### **1. Federal Requirements**

Once an updated FDD has been issued, a franchisor cannot continue using the previous version of the FDD.<sup>230</sup> However, unless the prospective franchisee makes a “reasonable request” for the updated FDD, the Franchise Rule does not strictly require a franchisor to furnish an updated FDD to a prospective franchisee that it has already disclosed with the old FDD.<sup>231</sup> Notwithstanding the lack of a formal requirement, best practice is that prospective franchisees who have not yet signed franchise agreements as of the issuance date of the updated FDD should be re-disclosed with the new FDD and the franchisor should wait an additional 14 calendar days (or longer time required by state law) before accepting any fees or a signed binding agreement.

### **2. State Requirements**

With respect to the Registration States, the safest approach is for a franchisor to cease offer and sales activity while a renewal or amendment application is pending with the state administrator. A few of the Registration States’ statutes provide specific procedures pursuant to which a franchisor can continue offering and selling while the application is under review. Typically, if a franchisor chooses to provide disclosure pursuant to these procedures, there are additional disclosures that the franchisor must make. California, as an example, allows a franchisor to provide the updated FDD to a prospective franchisee as long as the franchisor includes a disclaimer that the FDD is not yet registered with the state.<sup>232</sup> Then, once the updated FDD is approved, the franchisor must provide the FDD as approved (which may or may not include changes requested by the state) and a redline of any changes made while the registration was pending approval. The franchisor must then wait an additional before signing a binding agreement with or accepting payment from the prospective franchisee.<sup>233</sup> Importantly, this provision of the statute allows only for an offer while the registration is pending, but not a sale.<sup>234</sup> Rhode Island also allows a franchisor to continue offer activity while an application for amendment is pending. Under Rhode Island law, a franchisor may provide its pending FDD to a prospective franchisee before the FDD is approved, as long as once the new FDD is approved, the franchisor provides a redlined copy of the FDD showing any while the application was pending and waits an additional 10 business days before closing the sale with the approved FDD.<sup>235</sup> Although these provisions do not permit sales to be closed during this period, it does allow franchisors to keep prospects engaged in the sales process even though the new FDD has not yet been approved.

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<sup>230</sup> 16 C.F.R. § 436.7(a).

<sup>231</sup> Compliance Guide at 126.

<sup>232</sup> Cal. Corp. Code § 31107.

<sup>233</sup> *Id.*

<sup>234</sup> *Id.*

<sup>235</sup> 19 R.I. Gen. Laws. Ann. § 19-28.1-6(8).

New York, on the other hand, permits franchisors to complete a sale while an amendment is pending, as long as the franchisee is provided with a right to rescind the transaction.<sup>236</sup> Under applicable New York regulations, a franchisor can provide its current version of the FDD (i.e. not the FDD that was submitted for approval) with a disclaimer that the new FDD is pending approval. Franchisors can then, after observing the appropriate waiting periods, enter into a franchise agreement and collect fees as long as the fees are placed in an escrow account.<sup>237</sup> Once the new FDD has been approved, the franchisor must re-disclose the franchisee with the new FDD and provide the franchisee with 10 business days to rescind the transaction.<sup>238</sup>

## **V. Navigating Franchise Exemptions**

Once a business relationship meets the elements of a franchise under applicable law, franchisors are required to provide disclosure and otherwise comply with the state and federal laws describe above. However, the Franchise Rule and most Registration State laws provide several different exemptions which may obviate the disclosure or registration obligations. Exemptions can be based on a number of different criteria, but may involve an analysis of both a franchisor’s and a franchisee’s potential qualifications, as well as the particular specifics of the transaction. Importantly, qualifying for an exemption under the Franchise Rule, does not necessarily mean there will be a similarly applicable exemption under state law, and vice versa. The available exemptions differ under state and federal law, so prior to engaging in any transaction for which a franchisor plans to claim an exemption, franchisors must be perform a thorough analysis at both the state and federal law to ensure there is an applicable exemption.<sup>239</sup> This analysis should also include confirmation of whether the applicable state exemption eliminates the need for registration only, or if it exempts a franchisor from both registration and disclosure.

### **A. Franchise Rule Exemptions**

As previously noted, the Franchise Rule is a disclosure rule only. Thus, any exemption eliminates the requirement that a franchisor provide pre-sale disclosure.<sup>240</sup> Not every exemption is broadly applicable, but a summary of the most common exemptions is provided below.<sup>241</sup>

#### **1. Fractional Franchise Exemption**

A “fractional franchise” is generally a product or service that is added on to an existing business’ offer. This exemption requires that the relationship satisfy two criteria:

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<sup>236</sup> 13 Codes, Rules and Regulations of the State of New York, § 200.3(h)(3).

<sup>237</sup> *Id.*

<sup>238</sup> *Id.*

<sup>239</sup> For a comprehensive explanation of exemptions and exclusions, see *Exemptions and Exclusions Under Federal and State Franchise Registration and Disclosure Laws*, (Leslie D. Curan and Beata Krakus, eds., 2017).

<sup>240</sup> 16 C.F.R. § 436.8.

<sup>241</sup> See Alan R. Greenfield, Theresa Leets, and Karen B. Satterlee, *Franchise Disclosure Challenges for Large, Sophisticated, or Multi-Brand Franchise Companies*, 37th Annual ABA Forum on Franchising (2014), for a detailed discussion of the applicable federal and state franchise law exemptions.

(1) the franchisee, any of its current directors or officers, or any current directors or officers of a parent or affiliate, must have more than two years of experience in the same type of business as the franchise being offered or sold; and (2) the parties to the transaction must have a reasonable basis to anticipate 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.<sup>242</sup> The Franchise Rule provides that "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.<sup>243</sup> The example provided by the Compliance Guide is one where an ice cream store adds an offer of ice cream cake. These products are similar enough to satisfy the first requirement.<sup>244</sup>

The total sales volume requirement includes an analysis of all businesses owned and operated by the franchisee. Thus, if a franchisee owns many businesses, it can be more likely that it would qualify for a fractional franchise exemption. The sales attributable to the new product or service in proportion to the franchisee's total sales from operating its businesses is the analysis that must be performed to confirm the requirement has been met.

## **2. Minimal Franchise Fee Exemption**

The Franchise Rule also provides an exemption if the total amount of all payments required to be made by a franchisee to the franchisor (or any of its affiliates) at any time within the first six months of commencing operations are less than \$615.<sup>245</sup> Operations commence when the franchisee first makes goods or services available for sale. Some franchisors take advantage of this exemption by structuring payments due so that the franchisee will operate for a full six months before having to pay any amounts.

## **3. Large Franchisee Exemption**

The Franchise Rule further provides an exemption if the franchisee (or any of its affiliates) meets certain net worth and experience requirements. Currently, a franchisee (or any affiliate) must have net worth of at least \$6,165,500 and at least five years of business experience in the same or similar industry as the franchised business.<sup>246</sup> It is important to remember that the net worth and experience of affiliates and parents of the franchisee can be used to meet these criteria as the franchisee entity itself often may not qualify.

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<sup>242</sup> 16 C.F.R. § 436.1(g).

<sup>243</sup> Compliance Guide at 8.

<sup>244</sup> *Id.*

<sup>245</sup> 16 C.F.R. §436.8(a)(1). The Commission adjusted the minimum payment threshold to \$615, effective July 1, 2020.

<sup>246</sup> 16 C.F.R. § 436.8(a)(5)(ii). The Commission adjusted the minimum net worth requirement to \$6,165,500, effective July 1, 2020.

#### 4. Large Investment Exemption

If a franchisee is required to make an initial investment that equals or exceeds \$1,233,000, and the prospective franchisee signs an acknowledgment verifying the amount of the investment, then the transaction is exempt under the Franchise Rule.<sup>247</sup> The initial investment calculation must exclude the cost of unimproved land and any financing received from the franchisor or its affiliate. Further, the FTC specifies the exact language that the franchisee must acknowledge, which is:

The franchise sale is for more than \$1,233,000 – excluding the cost of unimproved land and any financing received from the franchisor or an affiliate – and thus is exempted from the Federal Trade Commission’s Franchise Rule disclosure requirements, pursuant to 16 CFR 436.8(a)(5)(i).<sup>248</sup>

The expenses that a franchisor provides in its Item 7 are the costs that should be considered in determining whether this exemption applies.<sup>249</sup> Future costs incurred during the term of the franchise cannot be used for purposes of meeting the investment threshold.<sup>250</sup>

#### 5. Other Exemptions

The Franchise Rule provides additional exemptions, including: (1) leased department, (2) insider exemption, (3) franchise relationships covered by the Petroleum Marketing Practice Act, or (4) oral franchises.<sup>251</sup> These exemptions do not routinely apply to many franchise business relationships, so further analysis should be performed should a franchisor rely on one of these.

##### B. State Exemptions

As indicated above, there must be an applicable federal and state exemption in order for a particular transaction to avoid registration and disclosure requirements. The exemptions available at the state and federal levels do not always align, so franchisors may need to review a variety of potential exemptions. In addition, state requirements for similar exemptions also do not always align, so an analysis of the particular state’s exemption criteria must be performed in every case. It is also critical to evaluate the scope of any particular exemption; exemption at the state level are often only from registration, not disclosure.

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<sup>247</sup>16 C.F.R. § 436.8(a)(5)(i). The Commission adjusted the large investment threshold to \$1,233,000, effective July 1, 2020.

<sup>248</sup> 16 C.F.R. § 436.8(a)(5)(i).

<sup>249</sup> Compliance Guide at 10.

<sup>250</sup> *Id.*

<sup>251</sup> 16 C.F.R. § 436.8(a)(3), (4), (6), and (7).

## **1. Large Franchisor Exemption**

In 7 Registration States (California, Illinois, Indiana, Maryland, New York, North Dakota, Rhode Island, Virginia and Washington), there is an exemption from registration if a franchisor meets certain net worth and experience requirements. Importantly, these exemptions do not eliminate the disclosure requirement in any of these states, so franchisors will still need to prepare an FDD and provide disclosure if they claim this exemption. The exemption criteria vary by state, but generally a franchisor (or a parent entity) must meet certain net worth thresholds (ranging from \$5 million to \$15 million) and have at least 5 years of experience in offering or selling franchises or operating the type of business that is the subject of the franchise. Some states also require that a franchisor have a minimum of 25 franchisees for the entire 5 year period preceding the claim of the exemption. States also vary with respect to how a franchisor must prove its net worth (i.e. whether the financial statements the franchisor is relying on must be audited), so a careful analysis of the state statute must be conducted in cases where audited financial statements are not prepared for a franchisor and/or parent. Note that no similar exemption exists under the Franchise Rule, so these exemptions are limited only to limiting the registration requirements in the particular states.

## **2. Large Franchisee Exemption**

California, Illinois, Rhode Island, South Dakota, Virginia, and Washington also provide an exemption based on the franchisee's net worth and experience. Similar to the large franchisor exemption, the criteria varies by state but generally requires that the prospective franchisee (or a parent or affiliate of the franchisee) have a certain net worth (most commonly \$5 million) and that the prospective franchisee (or its owners) have certain experience in operating the same or similar businesses as the subject of the franchise. As previously mentioned, the scope of the exemption varies and may not eliminate the disclosure requirement, so a careful analysis must be performed if relying on this exemption.

## **3. Fractional Franchise Exemption**

Nine states (California, Illinois, Indiana, Michigan, Minnesota, New York, South Dakota, Virginia, and Wisconsin) provide a fractional franchise exemption that mirrors the requirements of the Franchise Rule. Again, the criteria varies by state but generally the (1) the prospective franchisee must have a minimum of two years of experience in the same type of business and (2) the parties anticipate (or should anticipate) that the sales from the franchised business will not exceed 20% of the franchisee's total sales. Not, however, that some states also have criteria about the location from which the franchised business will operate, which can complicate the analysis.

## **4. Other Exemptions**

In addition to the exemptions identified above, other state exemptions include: (1) large investment exemption, (2) insider exemption, (3) institutional franchisee exemption, (4) single franchise exemption, (5) nominal fee exemption, (6) sale by judicial officer

exemption, (7) sale by existing franchisee exemption, (8) exemption by order, (9) leased department exemption, (10) securities exemption, (11) out-of-state exemption, and (12) exemption for renewal, extension, amendment, or modification of agreement.

## **VI. Additional Filing Requirements Beyond the FDD**

### **A. Franchise Seller / Broker Requirements**

As previously noted, most of the Registration States require franchisors to submit “franchise seller disclosure forms” in connection with the registration filings. These forms disclose certain information about the persons who will be offering and selling franchises on behalf of the franchisor, including the franchise seller’s previous five-year employment history, and whether the franchise seller has been involved in certain litigation or arbitration actions during the prior 10 years.<sup>252</sup> The Franchise Rule defines a “franchise seller” as “a person that offers, sells or arranges for the sale of a franchise. It includes the franchisor and the franchisor’s employees, representatives, agents, subfranchisors, and third-party brokers who are involved in franchise sales activities,” but does not include existing franchisees.<sup>253</sup> Note that the requirement to file franchise seller disclosure forms exists throughout the registration period, so franchisors may need to supplement the existing forms on file with the state if additional franchise sellers are hired or retained.

New York and Washington also have a separate requirement that third-party brokers register with the state as an authorized broker of the franchise system prior to engaging in any sales activities in the state.<sup>254</sup> New York’s franchise broker registration filing only has to be submitted once, while Washington’s broker registration filing must be renewed on an annual basis. Washington takes a broad definition of the term broker and requires that any employee of a franchisor’s parent, affiliate, or subsidiary maintain a franchise broker registration (either for the individual or the entity that employs the individual). Washington also requires a separate form to be submitted as part of the registration process that appoints the franchise broker as its representative in the state. If a franchisor plans to use third party brokers and/or its franchise sellers are employed by a parent, affiliate, or subsidiary, then the franchisor must confirm that all necessary broker registrations have been secured.

### **B. Costs and Source of Funds**

Most Registration States also require that franchisors submit a franchisors costs and source of funds page along with any initial or renewal filing.<sup>255</sup> On this page, a franchisor is required to indicate its total out-of-pocket “total costs for performing its pre-opening obligations to provide goods or services in connection with establishing each franchised business.”<sup>256</sup> The form specifies 5 categories that must be addressed (real

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<sup>252</sup> *Id.*

<sup>253</sup> 16 C.F.R. § 436.1(j).

<sup>254</sup> NY Franchise Registration Information Sheet, Bus, Franchise Guide (CCH) ¶ 5,320; Wash. Rev. Code Ann. § 19,100.140.

<sup>255</sup> NASAA Guidelines at II.A.2 and V. (Form B).

<sup>256</sup> *Id.*



estate, improvements, equipment, inventory, and training) and then provides an “other” category for franchisors to disclose any other costs that may be incurred. Note that this estimate need only include out-of-pocket costs and is intended to be exclusive of salaries and overhead the franchisor incurs. Franchisors must also specify the source of the funds, which generally includes franchise fees and/or general operating revenue.<sup>257</sup> State examiners typically use this form, along with a franchisors projected new franchise openings in Table 5 of Item 20, to analyze whether a franchisor has sufficient capital to fund its obligations and whether a financial assurance condition is going to be imposed.

### **C. Advertising Registration Requirements**

Six Registration States (California, Maryland, Minnesota, New York, North Dakota, and Washington) also require franchisors to submit advertising materials offering franchises for sale prior to their use in a particular state. The filing requirements for each of these states are summarized on Exhibit G, but generally require submission of the particular advertising materials which include state specific requirements (e.g. the advertising must include the franchisor’s address or the requirement that the Minnesota file number be included on the materials). Once submitted, unless a comment letter is issued, the advertising materials are deemed approved within a certain number of days after the state receives it.

The filing requirements above generally do not apply to advertisements over the internet, as long as the following conditions are met: (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.<sup>258</sup> Notwithstanding the lack of filing requirement, franchisors must ensure they are complying with state laws regarding registration before selling in a particular state. Moreover, it is highly recommended that franchisors include a disclaimer for any website advertising. An example of such a disclaimer is:

This information is not intended as an offer to sell, or the solicitation of an offer to buy, a franchise. It is for information purposes only. Currently, the following states regulate the offer and sale of franchises: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin. If you are a resident of or want to locate a franchise in one of these states, we will not offer you a franchise unless and until we have complied with applicable pre-sale registration and disclosure requirements in your state.

Franchisors should confirm that all of their franchise sellers are aware of the limitations in particular states and comply with the disclaimers on the website.

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<sup>257</sup> *Id.*

<sup>258</sup> Bus. Franchise Guide (CCH) ¶ 5,230.81 (Dec. 4, 2002).

## **VII. Conclusion**

A complete understanding of the laws and regulations that apply to the offer and sales of franchises in the United States cannot be gained from a single paper. Franchise attorneys must spend adequate time to learn the complexities and details of both franchised businesses and the laws that apply thereto in order to effectively advise their clients. This paper provides a mere introduction to the basics of these laws in an attempt to help practitioners ensure that franchisors are complying with all applicable obligations under both state and federal law.

## Exhibit A

### Form Item 9 Table

Obligation		Section in Agreement	Disclosure Document Item
a.	Site selection and acquisition/lease		
b.	Pre-opening purchases/lease		
c.	Site development and other pre-opening requirements		
d.	Initial and ongoing training		
e.	Opening		
f.	Fees		
g.	Compliance with standards and policies/Operating Manual		
h.	Trademarks and proprietary information		
i.	Restrictions on products/services offered		
j.	Warranty and customer service requirements		
k.	Territorial development and sales quotas		
l.	Ongoing product/service purchases		
m.	Maintenance, appearance and remodeling requirements		
n.	Insurance		
o.	Advertising		
p.	Indemnification		
q.	Owner's participation/management/staffing		
r.	Records and reports		
s.	Inspections and audits		
t.	Transfer		
u.	Renewal		
v.	Post-termination obligations		
w.	Non-competition covenants		
x.	Dispute resolution		
y.	Other (describe) [e.g. Personal Guaranty]		



**Exhibit C**

**Form Item 17 Chart**

## ITEM 17

### RENEWAL, TERMINATION, TRANSFER AND DISPUTE RESOLUTION

#### THE FRANCHISE RELATIONSHIP

**This table lists certain important provisions of the franchise and related agreements. You should read these provisions in the agreements attached to this Disclosure Document.**

Provision	Section in franchise or other agreement	Summary
(a) Length of the term of the franchise		
(b) Renewal or extension of the term		
(c) Requirements for you to renew or extend		
(d) Termination by you		
(e) Termination by us without cause		
(f) Termination by us with cause		
(g) "Cause" defined – defaults which can be cured		
(h) "Cause" defined – defaults which cannot be cured		
(i) Your obligations on termination/nonrenewal		
(j) Assignment of contract by us		
(k) "Transfer" by you-defined		
(l) Our approval of transfer by you		
(m) Conditions for our approval of transfer by you		
(n) Our right of first refusal to acquire your business		
(o) Our option to purchase your business		
(p) Your death or disability		
(q) Non-competition covenants during the term of the franchise		
(r) Non-competition covenants after the franchise is terminated or expires		
(s) Modification of the agreement		
(t) Integration/merger clause		
(u) Dispute resolution by arbitration or mediation		
(v) Choice of forum		
(w) Choice of law		

## Exhibit D

### Common State Risk Factors

Required Risk Factor page for all franchisors:

#### 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 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 litigate with the licensor 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.

Other common Risk Factors:

**Early State of Development**. The franchisor is at an early stage of development and has a limited operating history. This franchise is likely to be a riskier investment than a franchise in a system with a longer operating history.

**Financial Condition**. The franchisor’s financial condition, as reflected in its financial statements (see Item 21), calls into question the franchisor’s financial ability to provide services and support to you.

**Sales Performance Required**. You must maintain minimum sales performance levels. Your inability to maintain these levels may result in loss of any territorial rights you are granted, termination of your franchise, and loss of your investment.

**Mandatory Minimum Payments**. You must make minimum royalty payments or advertising fund payments, regardless of your sales levels. Your inability to make the payments may result in termination of your franchise and loss of your investment.

**Exhibit E**

**Sample State FDD Addenda**



## CALIFORNIA ADDENDUM TO FRANCHISE DISCLOSURE DOCUMENT

To the extent the California Franchise Investment Law, Cal. Corp. Code §§ 31000-31516 or the California Franchise Relations Act, Cal. Bus. & Prof. Code §§20000-20043 applies, the terms of this Addendum apply.

THE CALIFORNIA FRANCHISE INVESTMENT LAW REQUIRES THAT A COPY OF ALL PROPOSED AGREEMENTS RELATING TO THE SALE OF THE FRANCHISE BE DELIVERED TOGETHER WITH THE DISCLOSURE DOCUMENT.

OUR WEBSITE HAS NOT BEEN REVIEWED OR APPROVED BY THE CALIFORNIA DEPARTMENT OF BUSINESS OVERSIGHT AND COMPLAINTS CONCERNING THE CONTENTS OF THIS WEBSITE MAY BE DIRECTED TO THE CALIFORNIA DEPARTMENT OF BUSINESS OVERSIGHT AT .

SECTION 31125 OF THE CALIFORNIA CORPORATIONS CODE REQUIRES US TO GIVE YOU A DISCLOSURE DOCUMENT, IN A FORM CONTAINING THE INFORMATION THAT THE COMMISSIONER MAY BY RULE OR ORDER REQUIRE, BEFORE A SOLICITATION OF A PROPOSED MATERIAL MODIFICATION OF AN EXISTING FRANCHISE.

### Item 3, Additional Disclosure:

Neither we nor any person described in Item 2 of the Disclosure Document is subject to any currently effective order of any National Securities Association or National Securities Exchange, as defined in the Securities Exchange Act of 1934, 15 U.S.C.A. 78a et seq. suspending or expelling such persons from membership in such association or exchange.

### Item 6, Additional Disclosure:

The highest interest rate allowed by law in California is 10% annually.

### Item 17, Additional Disclosures:

The franchise agreement requires franchisee to execute a general release of claims upon renewal or transfer of the franchise agreement. California Corporations Code Section 31512 provides that any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of that law or any rule or order there under is void. Section 31512 voids a waiver of your rights under the Franchise Investment Law (California Corporations Code Section 20010 voids a waiver of your rights under the Franchise Relations Act (Business and Professions Code Sections 20000 – 20043).

The franchise agreement requires application of the laws of \_\_\_\_\_. This provision may not be enforceable under California law.

The franchise agreement contains a liquidated damages clause. Under California Civil Code §1671, certain liquidated damages clauses are unenforceable.

California Business and Professions Code Sections 20000 through 20043 provide rights to the franchisee concerning termination, transfer or non-renewal of a franchise. If the franchise agreement contains a provision that is inconsistent with the law, the law will control.

The franchise agreement provides for termination upon bankruptcy. This provision may not be enforceable under federal bankruptcy law (11 U.S.C.A. §101 et seq.)

The franchise agreement requires binding arbitration. The arbitration will occur in \_\_\_\_\_ with the cost being borne by the parties as determined by the arbitrator. Prospective franchisees are encouraged to consult with private legal counsel to determine the applicability of California and federal laws (such as Business and Professions Code Section 20040.5, Code of Civil Procedure Section 1281, and the Federal Arbitration Act) to any provisions of a franchise agreement restricting venue to a forum outside the State of California.

The franchise agreement contains a covenant not to compete which extends beyond the termination of the franchise. This provision may not be enforceable under California law.

Item 19, Additional Disclosures:

The financial performance figures do not reflect the costs of sales, operating expenses, or other costs or expenses that must be deducted from the gross revenue or gross sales figures to obtain your net income or profit. You should conduct an independent investigation of the costs and expenses you will incur in operating your franchised business. Franchisees or former franchisees listed in the Disclosure Document may be one source of this information.

## ILLINOIS ADDENDUM TO FRANCHISE DISCLOSURE DOCUMENT

To the extent the Illinois Franchise Disclosure Act, Ill. Comp. Stat. §§705/1 – 705/44 applies, the terms of this Addendum apply.

Item 17, Additional Disclosures. The following statements are added to Item 17:

The Illinois Franchise Disclosure Act governs the Franchise Agreement.

Section 4 of the Illinois Franchise Disclosure Act provides that any provision in a franchise agreement that designates jurisdiction or venue outside the State of Illinois is void. However, a franchise agreement may provide for arbitration outside of Illinois.

Section 41 of the Illinois Franchise Disclosure Act provides that any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with the Illinois Franchise Disclosure Act or any other law of Illinois is void.

Your rights upon termination and non-renewal of a franchise agreement are set forth in section 19 and 20 of the Illinois Franchise Disclosure Act.

## MARYLAND ADDENDUM TO FRANCHISE DISCLOSURE DOCUMENT

To the extent the Maryland Franchise Registration and Disclosure Law, Md. Code Bus. Reg. §§14-201 – 14-233 applies, the terms of this Addendum apply.

### Item 17, Additional Disclosures:

Our termination of the Franchise Agreement because of your bankruptcy may not be enforceable under applicable federal law (11 U.S.C.A. 101 et seq.).

You may bring a lawsuit in Maryland for claims arising under the Maryland Franchise Registration and Disclosure Law.

Any claims arising under the Maryland Franchise Registration and Disclosure Law must be brought within 3 years after the grant of the franchise.

The general release required as a condition of renewal, sale and/or assignment/transfer will not apply to any liability under the Maryland Franchise Registration and Disclosure Law.

## DISCLOSURES REQUIRED BY MICHIGAN LAW

To the extent the Michigan Franchise Investment Law, Mich. Comp. Laws §§445.1501 – 445.1546 applies, the terms of this Addendum apply.

THE STATE OF MICHIGAN PROHIBITS CERTAIN UNFAIR PROVISIONS THAT ARE SOMETIMES IN FRANCHISE DOCUMENTS. IF ANY OF THE FOLLOWING PROVISIONS ARE IN THESE FRANCHISE DOCUMENTS, THE PROVISIONS ARE VOID AND CANNOT BE ENFORCED AGAINST YOU.

(a) A prohibition on the right of a franchisee to join an association of franchisees.

(b) A requirement that a franchisee assent to a release, assignment, novation, waiver, or estoppel which deprives a franchisee of rights and protections provided in this act. This shall not preclude a franchisee, after entering into a franchise agreement, from settling any and all claims.

(c) A provision that permits a franchisor to terminate a franchise prior to the expiration of its term except for good cause. Good cause shall include the failure of the franchisee to comply with any lawful provision of the franchise agreement and to cure such failure after being given written notice thereof and a reasonable opportunity, which in no event need be more than 30 days, to cure such failure.

(d) A provision that permits a franchisor to refuse to renew a franchise without fairly compensating the franchisee by repurchase or other means for the fair market value at the time of expiration of the franchisee's inventory, supplies, equipment, fixtures, and furnishings. Personalized materials which have no value to the franchisor and inventory, supplies, equipment, fixtures, and furnishings not reasonably required in the conduct of the franchised business are not subject to compensation. This subsection applies only if: (i) the term of the franchise is less than 5 years, and (ii) the franchisee is prohibited by the franchise or other agreement from continuing to conduct substantially the same business under another trademark, service mark, trade name, logotype, advertising, or other commercial symbol in the same area subsequent to the expiration of the franchise or the franchisee does not receive at least 6 months advance notice of franchisor's intent not to renew the franchise.

(e) A provision that permits the franchisor to refuse to renew a franchise on terms generally available to other franchisees of the same class or type under similar circumstances. This section does not require a renewal provision.

(f) A provision requiring that arbitration or litigation be conducted outside this state. This shall not preclude the franchisee from entering into an agreement, at the time of arbitration, to conduct arbitration at a location outside this state.

(g) A provision which permits a franchisor to refuse to permit a transfer of ownership of a franchise, except for good cause. This subdivision does not prevent a

franchisor from exercising a right of first refusal to purchase the franchise. Good cause shall include, but is not limited to:

(i) The failure of the proposed transferee to meet the franchisor's then-current reasonable qualifications or standards.

(ii) The fact that the proposed transferee is a competitor of the franchisor or subfranchisor.

(iii) The unwillingness of the proposed transferee to agree in writing to comply with all lawful obligations.

(iv) The failure of the franchisee or proposed transferee to pay any sums owing to the franchisor or to cure any default in the franchise agreement existing at the time of the proposed transfer.

(h) A provision that requires the franchisee to resell to the franchisor items that are not uniquely identified with the franchisor. This subdivision does not prohibit a provision that grants to a franchisor a right of first refusal to purchase the assets of a franchise on the same terms and conditions as a bona fide third party willing and able to purchase those assets, nor does this subdivision prohibit a provision that grants the franchisor the right to acquire the assets of a franchise for the market or appraised value of such assets if the franchisee has breached the lawful provisions of the franchise agreement and has failed to cure the breach in the manner provided in subdivision (c).

(i) A provision which permits the franchisor to directly or indirectly convey, assign, or otherwise transfer its obligations to fulfill contractual obligations to the franchisee unless provision has been made for providing the required contractual services.

**THE FACT THAT THERE IS A NOTICE OF THIS OFFERING ON FILE WITH THE ATTORNEY GENERAL DOES NOT CONSTITUTE APPROVAL, RECOMMENDATION, OR ENDORSEMENT BY THE ATTORNEY GENERAL.**

If the franchisee has any questions regarding this notice, those questions should be directed to the Michigan Department of Attorney General, Consumer Protection Division, Attn.: Franchise, 670 Law Building, Lansing, Michigan 48913, telephone: (517) 373-7117.

## MINNESOTA ADDENDUM TO FRANCHISE DISCLOSURE DOCUMENT

To the extent the Minnesota Franchise Act, Minn. Stat. §§80C.01 – 80C.22 applies, the terms of this Addendum apply.

### State Cover Page and Item 17, Additional Disclosures:

Minn. Stat. Sec. 80C.21 and Minn. Rule 2860.4400J prohibit us from requiring litigation to be conducted outside of Minnesota, requiring waiver of a jury trial or requiring the franchisee to consent to liquidated damages, termination penalties or judgment notes. In addition, nothing in the Disclosure Document shall abrogate or reduce any of your rights as provided for in Minn. Stat. Sec. 80C, or your rights to any procedure, forum or remedies provided for by the laws of the jurisdiction.

Franchisee cannot consent to the franchisor obtaining injunctive relief. The franchisor may seek injunctive relief. A court will determine if a bond is required.

### Item 6, Additional Disclosure:

NSF checks are governed by Minn. Stat. 604.113, which puts a cap of \$30 on service charges.

### Item 13, Additional Disclosures:

The Minnesota Department of Commerce requires that a franchisor indemnify Minnesota Franchisees against liability to third parties resulting from claims by third parties that the franchisee's use of the franchisor's trademark infringes upon the trademark rights of the third party. The franchisor does not indemnify against the consequences of a franchisee's use of a franchisor's trademark except in accordance with the requirements of the franchise agreement, and as the condition to an indemnification, the franchisee must provide notice to the franchisor of any such claim immediately and tender the defense of the claim to the franchisor. If the franchisor accepts tender of defense, the franchisor has the right to manage the defense of the claim, including the right to compromise, settle or otherwise resolve the claim, or to determine whether to appeal a final determination of the claim.

### Item 17, Additional Disclosures:

Any condition, stipulation or provision, including any choice of law provision, purporting to bind any person who, at the time of acquiring a franchise is a resident of the State of Minnesota or in the case of a partnership or corporation, organized or incorporated under the laws of the State of Minnesota, or purporting to bind a person acquiring any franchise to be operated in the State of Minnesota to waive compliance or which has the effect of waiving compliance with any provision of the Minnesota Franchise Law is void.

We will comply with Minn. Stat. Sec. 80C.14, subds. 3, 4 and 5, which requires, except in certain specified cases, that a franchisee be given 90 days notice of termination (with 60 days to cure), 180 days notice for nonrenewal of the Franchise Agreement, and that consent to the transfer of the franchise will not be unreasonably withheld.

Minnesota Rule 2860.4400D prohibits a franchisor from requiring a franchisee to assent to a general release, assignment, novation, or waiver that would relieve any person from liability imposed by Minnesota Statute §§80C.01 – 80C.22.

The limitations of claims section must comply with Minn. Stat. Sec. 80C.17, subd. 5.



## NEW YORK ADDENDUM TO FRANCHISE DISCLOSURE DOCUMENT

To the extent the New York General Business Law, Article 33, §§680 - 695 applies, the terms of this Addendum apply.

### Cover Page, Additional Disclosure.

INFORMATION COMPARING FRANCHISORS IS AVAILABLE. CALL THE STATE ADMINISTRATORS LISTED IN EXHIBIT \_\_\_ OR YOUR PUBLIC LIBRARY FOR SOURCES OF INFORMATION. REGISTRATION OF THIS FRANCHISE BY NEW YORK STATE DOES NOT MEAN THAT NEW YORK STATE RECOMMENDS IT OR HAS VERIFIED THE INFORMATION IN THIS FRANCHISE DISCLOSURE DOCUMENT. IF YOU LEARN THAT ANYTHING IN THE FRANCHISE DISCLOSURE DOCUMENT IS UNTRUE, CONTACT THE FEDERAL TRADE COMMISSION AND NEW YORK STATE DEPARTMENT OF LAW, BUREAU OF INVESTOR PROTECTION AND SECURITIES, 120 BROADWAY, 23RD FLOOR, NEW YORK, NEW YORK 10271. THE FRANCHISOR MAY, IF IT CHOOSES, NEGOTIATE WITH YOU ABOUT ITEMS COVERED IN THE FRANCHISE DISCLOSURE DOCUMENT. HOWEVER, THE FRANCHISOR CANNOT USE THE NEGOTIATING PROCESS TO PREVAIL UPON A PROSPECTIVE FRANCHISEE TO ACCEPT TERMS WHICH ARE LESS FAVORABLE THAN THOSE SET FORTH IN THIS FRANCHISE DISCLOSURE DOCUMENT.

Item 3, Additional Disclosure. The last sentence in Item 3 is deleted and replaced with the following:

Neither we, nor any of our predecessors, nor any person identified in Item 2 above, nor any affiliate offering franchises under our trademark, has any administrative, criminal, or a material civil or arbitration action pending against him alleging a violation of any franchise law, fraud, embezzlement, fraudulent conversion, restraint of trade, unfair or deceptive practices, misappropriation of property, or comparable allegations.

Neither we, nor any of our predecessors, nor any person identified in Item 2 above, nor any affiliate offering franchises under our trademark, has been convicted of a felony or pleaded nolo contendere to any other felony charge or, during the ten-year period immediately preceding the application for registration, been convicted of a misdemeanor or pleaded nolo contendere to any misdemeanor charge or been found liable in an arbitration proceeding or a civil action by final judgment, or been the subject of any other material complaint or legal or arbitration proceeding if such misdemeanor conviction or charge, civil action, complaint, or other such proceeding involved a violation of any franchise law, securities law, fraud, embezzlement, fraudulent conversion, restraint of trade, unfair or deceptive practices, misappropriation of property, or comparable allegation.

Neither we, nor any of our predecessors, nor any person identified in Item 2 above, nor any affiliate offering franchises under our trademark, is subject to any currently effective injunctive or restrictive order or decree relating to franchises, or under any federal, state, or Canadian franchise, securities, antitrust, trade regulation, or

trade practice law as a result of a concluded or pending action or proceeding brought by a public agency; or is subject to any currently effective order of any national securities association or national securities exchange, as defined in the Securities and Exchange Act of 1934, suspending or expelling such person from membership in such association or exchange; or is subject to a currently effective injunctive or restrictive order relating to any other business activity as a result of an action brought by a public agency or department, including, without limitation, actions affecting a license as a real estate broker or sales agent.

Item 4, Additional Disclosure. Item 4 is deleted and replaced with the following:

Neither we nor any of our predecessors, affiliates, or officers, during the 10-year period immediately before the date of the Disclosure Document: (a) filed as debtor (or had filed against it) a petition to start an action under the U.S. Bankruptcy Code; (b) obtained a discharge of its debts under the Bankruptcy Code; or (c) was a principal officer of a company or a general partner in a partnership that either filed as a debtor (or had filed against it) a petition to start an action under the U.S. Bankruptcy Code or that obtained a discharge of its debts under the U.S. Bankruptcy Code during or within one year after the officer or general partner of the franchisor held this position in the company or partnership.

Item 5, Additional Disclosures.

The initial franchise fee constitutes part of our general operating funds and will be used as such in our discretion.

Item 17, Additional Disclosures.

The following is added to the Summary sections of Item 17(c) and 17(m): To the extent required by applicable law, all rights you enjoy and any causes of action arising in your favor from the provisions of Article 33 of the General Business Law of the State of New York and the regulations issued thereunder shall remain in force; it being the intent of this proviso that the non-waiver provisions of General Business Law Section 687.4 and 687.5 be satisfied.

The Summary section of Item 17(d) is deleted and replaced with the following language: You may terminate the agreement on any grounds available by law.

The following is added to the Summary section of Item 17(j): No assignment will be made except to an assignee who in good faith and judgment of the franchisor is willing and financially able to assume the franchisor's obligations under the Franchise Agreement.

The following is added to the Summary sections of Items 17(v) and 17(w): The foregoing choice of law should not be considered a waiver of any right conferred upon the franchisor or upon the franchisee by Article 33 of the General Business Law of the State of New York.

## NORTH DAKOTA ADDENDUM TO FRANCHISE DISCLOSURE DOCUMENT

To the extent the North Dakota Franchise Investment Law, N.D. Cent. Code, §§51-19-01 – 51-19-17 applies, the terms of this Addendum apply.

Item 17, Additional Disclosures. The following statements are added to Item 17:

Any provision requiring franchisees to consent to the jurisdiction of courts outside North Dakota or to consent to the application of laws of a state other than North Dakota may be unenforceable under North Dakota law. Any mediation or arbitration will be held at a site agreeable to all parties. If the laws of a state other than North Dakota govern, to the extent that such law conflicts with North Dakota law, North Dakota law will control.

Any general release the franchisee is required to assent to as a condition of renewal is not intended to nor shall it act as a release, estoppel or waiver of any liability franchisor may have incurred under the North Dakota Franchise Investment Law.

Covenants not to compete during the term of and upon termination or expiration of the franchise agreement are enforceable only under certain conditions according to North Dakota law. If the Franchise Agreement contains a covenant not to compete that is inconsistent with North Dakota law, the covenant may be unenforceable.

The Franchise Agreement includes a waiver of exemplary and punitive damages. This waiver may not be enforceable under North Dakota law.

The Franchise Agreement stipulates that the franchisee shall pay all costs and expenses incurred by franchisor in enforcing the agreement. For North Dakota franchisees, the prevailing party is entitled to recover all costs and expenses, including attorneys' fees.

The Franchise Agreement requires the franchisee to consent to a waiver of trial by jury. This waiver may not be enforceable under North Dakota law.

The Franchise Disclosure Document and Franchise Agreement state that franchisee must consent to the jurisdiction of courts outside that State of North Dakota. That requirement may not be enforceable under North Dakota law.

The Franchise Disclosure Document and Franchise Agreement may require franchisees to consent to termination or liquidated damages. This requirement may not be enforceable under North Dakota law.

The Franchise Agreement requires the franchisee to consent to a limitation of claims within one year. To the extent this requirement conflicts with North Dakota law, North Dakota law will apply.

## RHODE ISLAND ADDENDUM TO FRANCHISE DISCLOSURE DOCUMENT

To the extent the Rhode Island Franchise Investment Act, R.I. Gen. Law ch. 395 §§19-28.1-1 – 19-28.1-34 applies, the terms of this Addendum apply.

Item 17, Additional Disclosure. The following statement is added to Item 17:

Section 19-28.1-14 of the Rhode Island Franchise Investment Act provides that:  
“A provision in a franchise agreement restricting jurisdiction or venue to a forum outside this state or requiring the application of the laws of another state is void with respect to a claim otherwise enforceable under this Act.”

## VIRGINIA ADDENDUM TO FRANCHISE DISCLOSURE DOCUMENT

To the extent the Virginia Retail Franchising Act, Va. Code §§13.1-557 – 13.1-574 applies, the terms of this Addendum apply.

### Item 17, Additional Disclosures:

Any provision in any of the contracts that you sign with us which provides for termination of the franchise upon the bankruptcy of the franchisee may not be enforceable under federal bankruptcy law (11 U.S.C. 101 et. seq.).

“According to Section 13.1 – 564 of the Virginia Retail Franchising Act, it is unlawful for a franchisor to cancel a franchise without reasonable cause. If any grounds for default or termination stated in the franchise agreement does not constitute “reasonable cause,” as that term may be defined in the Virginia Retail Franchising Act or the laws of Virginia, that provision may not be enforceable.”

## WASHINGTON ADDENDUM TO FRANCHISE DISCLOSURE DOCUMENT

1. In the event of a conflict of laws, the provisions of the Washington Franchise Investment Protection Act, Chapter 19.100 RCW shall prevail.
2. RCW 19.100.180 may supersede the Franchise Agreement in your relationship with us including the areas of termination and renewal of your franchise. There may also be court decisions which may supersede the Franchise Agreement in your relationship with us including the areas of termination and renewal of your franchise.
3. In any arbitration or mediation involving a franchise purchased in Washington, the arbitration or mediation site will be either in the state of Washington, or in a place mutually agreed upon at the time of the arbitration or mediation, or as determined by the arbitrator or mediator at the time of arbitration or mediation. In addition, if litigation is not precluded by the Franchise Agreement, a franchisee may bring an action or proceeding arising out of or in connection with the sale of franchises, or a violation of the Washington Franchise Investment Protection Act, in Washington.
4. A release or waiver of rights executed by a franchisee may not include rights under the Washington Franchise Investment Protection Act or any rule or order thereunder except when executed pursuant to a negotiated settlement after the agreement is in effect and where the parties are represented by independent counsel. Provisions such as those which unreasonably restrict or limit the statute of limitations period for claims under the Act, or rights or remedies under the Act such as a right to a jury trial, may not be enforceable.
5. Transfer fees are collectable to the extent that they reflect our reasonable estimated or actual costs in effecting a transfer.
6. Pursuant to RCW 49.62.020, a noncompetition covenant is void and unenforceable against an employee, including an employee of an area representative, unless the employee's earnings from the party seeking enforcement, when annualized, exceed \$100,000 per year (an amount that will be adjusted annually for inflation). In addition, a noncompetition covenant is void and unenforceable against an independent contractor of a franchisee under RCW 49.62.030 unless the independent contractor's earnings from the party seeking enforcement, when annualized, exceed \$250,000 per year (an amount that will be adjusted annually for inflation). As a result, any provisions contained in the Franchise Agreement or elsewhere that conflict with these limitations are void and unenforceable in Washington.
7. RCW 49.62.060 prohibits a franchisor from restricting, restraining, or prohibiting a franchisee from (i) soliciting or hiring any employee of a franchisee of the same franchisor or (ii) soliciting or hiring any employee of the franchisor. As a result, any

such provisions contained in the Franchise Agreement or elsewhere are void and unenforceable in Washington.

8. The franchisor may use the services of franchise brokers to assist it in selling franchises. A franchise broker represents the franchisor and is paid a fee for referring prospects to the franchisor and/or selling the franchise. Do not rely only on the information provided by a franchise broker about a franchise. Do your own investigation by contacting the franchisor's current and former franchisees to ask them about their experience with the franchisor.

## **Exhibit F**

### **State Registration Requirements**



## **INITIAL FRANCHISE REGISTRATION APPLICATION REQUIREMENTS:**

### **California**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Corporate Acknowledgment
4. Certification Page
5. Customer Authorization of Disclosure of Financial Records
6. Notice of Exemption for Internet Advertising
7. 1 copy of Franchise Disclosure Document
8. Auditors' Consent form
9. Franchise Seller Disclosure Forms
10. Franchisor's Costs and Source of Funds Page
11. 1 copy of Advertising or Promotional Materials
12. Filing Fee of \$675.00

### **Hawaii**

1. Uniform Franchise Registration Application Facing Page
2. 2 copies of Franchise Disclosure Document – (Clean & Redline)
3. Auditors' Consent form
4. Franchise Seller Disclosure Forms
5. Franchisor's Costs and Source of Funds Page
6. Filing Fee of \$250.00

### **Illinois**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Corporate Acknowledgment
4. Certification Page
5. 2 copies of Franchise Disclosure Document
6. Auditors' Consent form
7. Franchise Seller Disclosure Forms
8. Franchisor's Costs and Source of Funds Page
9. Filing Fee of \$500.00 made payable to the State of Illinois

## **Indiana**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Corporate Acknowledgment
4. 1 copy of Franchise Disclosure Document
5. Franchise Seller Disclosure Forms
6. Filing Fee of \$500.00

## **Maryland**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Corporate Acknowledgment
4. Certification Page
5. 2 copies of Franchise Disclosure Document
6. Auditors' Consent form
7. Franchise Seller Disclosure Forms
8. Franchisor's Costs and Source of Funds
9. 2 copies of Advertising or Promotional Materials
10. Filing Fee of \$500.00

## **Michigan**

Annual Notice Filing which consists of:

1. Letter to the Attorney General; and
2. Filing Fee of \$250.00

## **Minnesota**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Corporate Acknowledgment
4. Certification Page
5. 1 copy of Franchise Disclosure Document
6. Auditors' Consent form
7. Franchise Seller Disclosure Forms
8. Franchisor's Costs and Source of Funds Page
9. 1 copy of Advertising or Promotional Materials
10. Filing Fee of \$400.00

## **New York**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Corporate Acknowledgment
4. Certification Page
5. Franchisor's Costs and Source of Funds Page
6. 2 copies of Franchise Disclosure Document
7. Auditors' Consent form
8. Franchise Seller Disclosure Forms
9. 2 copies Advertising or Promotional Materials (accompanied by an executed New York Verification Form and stamped with New York legend)
10. Filing Fee of \$750.00
11. Franchise Broker Registration Required

## **North Dakota**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Corporate Acknowledgment
4. Certification Page
5. Franchisor's Costs and Source of Funds Page
6. 1 copy of Franchise Disclosure Document
7. Auditors' Consent form
8. Franchise Seller Disclosure Forms
9. 1 copy of Advertising or Promotional Materials
10. Filing Fee of \$250.00

## **Rhode Island**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Corporate Acknowledgment
4. Certification Page
5. Franchisor's Costs and Source of Funds Page
6. 1 copy of Franchise Disclosure Document
7. Auditors' Consent form
8. Franchise Seller Disclosure Forms
9. 1 copy of Advertising or Promotional Materials
10. Filing Fee of \$600.00

## **South Dakota**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Certification Page
4. 1 CD-ROM copy of Franchise Disclosure Document
5. Filing Fee of \$250.00

## **Virginia**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Corporate Acknowledgment
4. Certification Page
5. Franchisor's Costs and Source of Funds Page
6. 2 copies of Franchise Disclosure Document
7. Auditors' Consent form
8. Filing Fee of \$500.00

## **Washington**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Corporate Acknowledgment
4. Certification Page
5. Franchisor's Costs and Source of Funds Page
6. 2 copies of Franchise Disclosure Document
7. Auditors' Consent form
8. Franchise Seller Disclosure Forms
9. 1 copy of Advertising or Promotional Materials
10. Filing Fee of \$600.00
11. Franchise Broker Registration Required

## **Wisconsin**

1. 1 copy of Franchise Disclosure Document
2. Filing Fee of \$400.00

## **FRANCHISE REGISTRATION RENEWAL APPLICATION REQUIREMENTS:**

### **California**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Corporate Acknowledgment
4. Certification Page
5. Franchisor's Costs and Source of Funds Page (with budget attached)
6. Customer Authorization of Disclosure of Financial Records
7. Notice of Exemption for Internet Advertising
8. 2 copies of Franchise Disclosure Document (clean and redline)
9. Auditors' Consent form
10. Franchise Seller Disclosure Forms
11. 1 copy of Advertising or Promotional (new or revised)
12. Filing Fee of \$450.00

### **Hawaii**

1. Uniform Franchise Registration Application
2. Franchisor's Costs and Source of Funds Page
3. 2 copies of Franchise Disclosure Document (Clean & Redline)
4. Auditors' Consent form
5. Franchise Seller Disclosure Forms
6. Filing Fee of \$250.00

### **Illinois**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process/Corporate Acknowledgment
3. Certification Page
4. Franchisor's Costs and Source of Funds Page
5. 2 copies of Franchise Disclosure Document (Clean & Redline)
6. Auditors' Consent form
7. Franchise Seller Disclosure Forms
8. Filing Fee of \$100.00

## **Indiana**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Corporate Acknowledgment
4. 1 copy of Franchise Disclosure Document
5. Franchise Seller Disclosure Forms
6. Filing Fee of \$250.00

## **Maryland**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Corporate Acknowledgment
4. Certification Page
5. Franchisor's Costs and Source of Funds Page
6. 2 copies of Franchise Disclosure Document (Clean & Redline)
7. Auditors' Consent form
8. Franchise Seller Disclosure Forms
9. 2 copies of Advertising or Promotional Materials (new or revised)
10. Filing Fee of \$250.00

## **Michigan**

Annual Notice Filing which consists of:

1. Letter to the Attorney General; and
2. Filing Fee of \$250.00

## **Minnesota**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Corporate Acknowledgement
4. Certification Page
5. Franchisor's Costs and Source of Funds Page (with budget attached)
6. 1 copy of Franchise Disclosure Document (Redline)
7. Auditors' Consent form
8. Franchise Seller Disclosure Forms
9. 1 copy of Advertising or Promotional Materials
10. Filing Fee of \$300.00

## **New York**

1. Uniform Franchise Registration Application Facing Page
2. Certification Page
3. Franchisor's Costs and Source of Funds Page
4. 2 bound copies of Franchise Disclosure Document (Clean & Redline)
5. Auditors' Consent form
6. Franchise Seller Disclosure Forms
7. 2 copies Advertising or Promotional Materials
8. Filing Fee of \$150.00
9. Annual Report

## **North Dakota**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Corporate Acknowledgment
4. Certification Page
5. Franchisor's Costs and Source of Funds Page
6. 2 copies of Franchise Disclosure Document (Clean & Redline)
7. Auditors' Consent form
8. Franchise Seller Disclosure Forms
9. 1 copy of Advertising or Promotional Materials (new or revised)
10. Filing Fee of \$100.00

## **Rhode Island**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Corporate Acknowledgment
4. Certification Page
5. Franchisor's Costs and Source of Funds Page
6. 2 copies of Franchise Disclosure Document
8. Franchise Seller Disclosure Forms
9. 1 copy of Advertising and Promotional Materials (new or revised)
10. Filing Fee of \$300.00

## **South Dakota**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service or Process
3. Corporate Acknowledgment
4. Certification Page
5. 1 copy of Franchise Disclosure Document
6. Filing Fee of \$150.00

## **Virginia**

1. Uniform Franchise Registration Application Facing Page
2. Certification Page
3. Franchisor's Costs and Source of Funds Page
4. 2 copies of Franchise Disclosure Document (Clean & Redline)
5. Auditors' Consent form
6. Filing Fee of \$250.00

## **Washington**

1. Uniform Franchise Registration Application Facing Page
2. Uniform Consent to Service of Process
3. Corporate Acknowledgment
4. Certification Page
5. Franchisor's Costs and Source of Funds Page
6. 2 copies of Franchise Disclosure Document (Clean & Redline)
7. Auditors' Consent form
8. Franchise Seller Disclosure Forms
9. 1 copy of Advertising or Promotional Materials (new or revised)
10. Filing Fee of \$100.00
11. Franchise Broker Registration Renewal Required

## **Wisconsin**

1. 1 copy of Franchise Disclosure Document (Clean)
2. Filing Fee of \$400.00 made payable to the State of Wisconsin



## **POST-EFFECTIVE AMENDMENT FRANCHISE FILING REQUIREMENTS:**

### **California**

1. Uniform Franchise Registration Application Facing Page
2. Certification Page
3. 1 copy of amended Franchise Disclosure Document (Redline)
4. Filing Fee of \$50.00

### **Hawaii**

1. Uniform Franchise Registration Application
2. Certification Page
3. 2 copies of amended Franchise Disclosure Document (Clean & Redline)
3. Filing Fee of \$250.00

### **Illinois**

1. Uniform Franchise Registration Application Facing Page
2. Certification Page
3. 2 copies of amended Franchise Disclosure Document (Clean & Redline)
4. Filing Fee of \$100.00

### **Indiana**

Amended FDD to be uploaded to securities portal website

### **Maryland**

1. Uniform Franchise Registration Application Facing Page
2. Certification Page
3. 2 copies of amended Franchise Disclosure Document (Clean & Redline)
4. Filing Fee of \$100.00

### **Michigan**

Not Required

### **Minnesota**

1. Uniform Franchise Registration Application Facing Page
2. Certification Page
3. 1 copy of amended Franchise Disclosure Document (Redline)
4. Filing Fee of \$100.00

### **New York**

1. Uniform Franchise Application Facing Page
2. Certification Page
3. 2 copies of amended Franchise Disclosure Document (Clean & Redline)
4. Filing Fee of \$150.00

### **North Dakota**

1. Uniform Franchise Registration Application Facing Page
2. Certification Page
3. 2 copies of amended Franchise Disclosure Document (Clean & Redline)
4. Filing Fee of \$50.00

### **Rhode Island**

1. Uniform Franchise Registration Application Facing Page
2. Certification Page
3. 2 copies of amended Franchise Disclosure Document (Clean & Redline)
4. Filing Fee of \$100.00

### **South Dakota**

Not Required

### **Virginia**

1. Uniform Franchise Registration Application Facing Page
2. Disclosure Verification Page
3. 2 copies of amended Franchise Disclosure Document (Clean & Redline)
4. Filing Fee of \$100.00

### **Washington**

1. Uniform Franchise Registration Application Facing Page
2. Certification Page
3. 2 copies of amended Franchise Disclosure Document (Clean & Redline)
4. Filing Fee of \$100.00

### **Wisconsin**

1. 1 copy of amended Franchise Disclosure Document (Clean)
2. Filing Fee of \$200.00 made payable to the State of Wisconsin

## Exhibit G

### Advertising Registration Requirements

State	How Far In Advance Of Publication or Use Must Ad Be Submitted	Is There A Fee?	Number of Copies To Be Filed	Will State Respond On Approval?
California	3 business days	No	1	No
Maryland (1)	7 business days	No	2	No
Minnesota (2)	5 business days (but will be disallowed (if at all) within 3 business days)	No	1	No
New York (3)	7 days	No	2	Yes
North Dakota	5 business days	No	1	No
Rhode Island	5 business days	Yes (\$10.00)	1	No
Washington	7 days	No	1	No

- (1) Maryland requires that all advertising state the name and address of the person sponsoring the advertisement or making the offer.
- (2) Minnesota requires the registration file number to be placed on the advertisement. Name and address of franchisor has to be included in the advertisement.
- (3)
  - (a) New York requires that a statement signed by the franchisor be filed with the ad stating that the ad is not inconsistent with the Franchise Disclosure Document.
  - (b) New York also requires one of the following two legends to appear on each advertisement:
    - (i) All sales literature used in connection with franchise offerings must contain the following statement in easily readable print:

This advertisement is not an offering. An offering can only be made by a prospectus filed first with the Department of

Law of the State of New York. Such filing does not constitute approval by the Department of Law.

- (ii) In all classified type of advertisements not more than five inches long and no more than one column of print wide, and in all broadcast advertising thirty seconds or less in duration, the following statement may be used:

"This offering is made by prospectus only."