THE ART AND SCIENCE OF
FDD DRAFTING

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# Table of Contents

I. INTRODUCTION ........................................................................................................ 1

II. COMPLYING WITH FEDERAL FRANCHISE LAW ................................................ 1

A. General FDD Preparation Requirements .......................................................... 2
   1. Plain English .................................................................................................. 2
   2. Single Document .......................................................................................... 3
   3. Address Each Disclosure Item / Address Nothing More .............................. 3

B. Cover Pages ....................................................................................................... 5

C. Table of Contents ............................................................................................... 7

D. Item 1 ................................................................................................................ 7

E. Item 2 ................................................................................................................ 8

F. Item 3 ................................................................................................................ 8

G. Item 4 ................................................................................................................ 9

H. Item 5 ............................................................................................................... 10

I. Item 6 ................................................................................................................. 11

J. Item 7 ............................................................................................................... 13

K. Item 8 ............................................................................................................... 15

L. Item 9 ............................................................................................................... 15

M. Item 10 ........................................................................................................... 16

N. Item 11 ............................................................................................................. 18
   1. General Pre- and Post-Opening Obligations .............................................. 18
   2. Advertising .................................................................................................. 19
   3. Technology ................................................................................................. 19
   4. Training ....................................................................................................... 19
   5. Manual Table of Contents ........................................................................ 20

O. Item 12 ............................................................................................................. 20

P. Item 13 ............................................................................................................. 21

Q. Item 14 ............................................................................................................. 22

R. Item 15 ............................................................................................................. 23

S. Item 16 ............................................................................................................. 24
III. THE ART AND SCIENCE OF MINIMIZING THE POTENTIAL FOR CLAIMS

A. The Franchisor’s Duty to Disclose

B. Disclaimers and Non-Reliance Clauses

IV. THE ART AND SCIENCE OF SELLING THE SYSTEM

V. CONCLUSION

Biographies
THE ART AND SCIENCE OF FDD DRAFTING

I. INTRODUCTION

Developing a well-crafted franchise disclosure document ("FDD") is both a science and an art. When the science of meeting the disclosure requirements is combined with the art of drafting language in a clear and concise manner, a practitioner can produce an FDD that provides complete and accurate information that is not misleading, is easily understandable by prospective franchisees, and serves as a sales tool for franchise sellers. In this paper, we discuss three key goals of FDD drafting: (1) complying with the law; (2) minimizing potential claims by the franchisee; and (3) selling the system. Within each of these sections, we identify key challenges practitioners may face when drafting an FDD and provide various approaches to dealing with these challenges.

II. COMPLYING WITH FEDERAL FRANCHISE LAW

Federal and state franchise laws provide the framework and baseline for developing an FDD by requiring the disclosure of certain information about a franchise system. This forms the science underlying the production of an FDD. The laws require certain disclosures and practitioners insert such disclosures into FDDs in a methodical, scientific fashion. In some cases, federal and state laws even prescribe the format in which the franchisor must present certain information. For example, the laws have broken the disclosure requirements into a cover page, table of contents, and 23 Items. Each individual Item provides prospective franchisees with specific information regarding the franchise system, but the Items are also often interrelated. Taken together, the Items of an FDD provide readers with an in-depth summary of the franchise opportunity being offered. Within individual Items, the Federal Trade Commission Franchise Rule ("FTC Rule")\(^2\) regulates the way the information is presented. This is especially the case in Items 6, 7, 9, 17, and 20, which require the use of pre-established tables. These regulations add to the scientific nature of building an FDD. But even in some of these more regulated Items, there is room for a practitioner to use artful techniques to describe the franchise system in the light most favorable to the franchisor. This is where the art behind FDD drafting comes into play.

In this section of the paper, we will analyze the FDD disclosure requirements of the FTC Rule one Item at a time. In doing this, we will divide our analysis of each Item into two parts: (1) the science; and (2) the art. We first look to the required disclosures of each Item, what we call the "science." We then discuss ways in which a practitioner may use the disclosure requirements to its advantage, and also identify areas where a practitioner may not deviate from bare requirements, what we call the "art." It is important to bear in mind that state franchise laws may have additional requirements; and, although we highlight a few state-specific FDD issues, a state-specific analysis is outside the scope of this paper.

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1 The authors wish to thank Andrea Gregory, an associate, and Margaret Loveless and Halima Madjid, paralegals, with Plave Koch PLC for their contributions to this paper.

A. General FDD Preparation Requirements

1. Plain English

The FDD must be presented in plain English using clear and concise language,\(^3\) which is intended to make it easier for prospective franchisees to understand the information being disclosed. The science behind meeting this requirement requires a practitioner to understand what “plain English” means. Fortunately, the FTC Compliance Guide (“Compliance Guide”) offers insight as to the FTC’s expectations. In its attempt to help practitioners navigate the requirements involved in producing an FDD, the Compliance Guide defines “plain English” as:

the organization of information and language usage understandable by a person unfamiliar with the franchise business. It incorporates short sentences; definitive, concrete, everyday language; active voice; tabular presentation of information, where possible. It avoids legal jargon, highly technical business terms, and multiple negatives.\(^4\)

As for the art of meeting the “plain English” requirement, we highlight three points. First, presenting the information required in the various Items of the FDD in a clear and concise manner is, in and of itself, a form of art. It often requires great skill to explain the complex legal implications of a franchise agreement in layman’s terms.

Second, practitioners may elect to use a certain font for the FDD. Different fonts can be used to give the entire franchise system a particular feel and set the stage for the relationship between the parties. Although changing the font of an FDD does not change the substance, some franchisors prefer one font over the other for all documents because they feel certain fonts are easier to read or have a less “legal feel.”

Lastly, when discussing certain information in one Item of an FDD, some practitioners like to include cross-references to other Items that discuss the topic in fuller detail. This can be helpful because it directs readers to additional information. Unfortunately, the negatives often outweigh the positives of including such references. With each annual update of the FDD, it is possible that the references will change and practitioners may miss updating the corresponding references. Failing to update the references as needed will confuse potential franchisees rather than help them find additional information. Furthermore, some state examiners have requested that practitioners remove such cross-references because it can confuse the reader, who is not likely familiar with the layout and function of the FDD. Examiners that request the removal of such cross-references are likely looking for the FDD to provide exactly the information required in exactly the location it is required to be disclosed, and not unnecessarily repeated or referenced in other Items. The added time it takes to receive the examiner’s request, remove the references, and respond to the examiner slows down the registration process and increases the overall cost a franchisor will have to pay to have an FDD prepared.

These three artistic points, taken together with the science behind the “plain English” requirement, assist a practitioner in drafting the FDD in a voice and tone suitable for each unique franchise system.

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\(^4\) Id.
2. **Single Document**

While the FDD is comprised of various disclosure Items, exhibits and attachments, the FDD must be presented in a “single document - it cannot be presented in multiple, discrete parts.” Franchisors cannot, among other things, include links to external documents, cannot give the FDD in multiple pieces, and cannot separate out parts of the FDD (for example the receipt pages). This requirement is very scientific in nature and leaves little room for artistic formatting of the FDD. The rule is clear, the FDD must be provided as a single document.

3. **Address Each Disclosure Item / Address Nothing More**

Certain general requirements restrict how much liberty practitioners can take with the art of FDD writing by mandating clear, inflexible rules. For example, when preparing the FDD, franchisors must address every required disclosure requirement in the 23 Items in the FTC Rule. If any required disclosure is not applicable to the franchise system, then the FDD must include a negative response to the required disclosure. Examples include:

- **Item 3:** No litigation is required to be disclosed in this Item.
- **Item 4:** No bankruptcy information is required to be disclosed in this Item.
- **Item 10:** We do not offer any direct or indirect financing.
- **Item 18:** We do not use any public figure to promote the franchise.

Also, the FTC Rule prohibits franchisors from including in the FDD any information that is not required or expressly permitted, either by the FTC Rule or by state law. The Compliance Guide specifically notes that franchisors “may not include testimonials or promotional literature in [the FDD].” Furthermore, if a statement is prescribed or required by the FTC Rule, such statements cannot be modified – these statements must be presented verbatim as specified in the FTC Rule. Some such prescribed statements are:

- **FTC Cover Page:** *Note, however, that no governmental agency has verified the information contained in this document.*

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5 *Id.*
6 *Id.*
7 *Id. at* 121 - 22.
8 *Id. at* 122.
9 *Id.*
10 *Id.*
11 16 C.F.R. § 436.3(e)(2).
Item 9: This table lists your principal obligations under the franchise and other agreements. It will help you find more detailed information about your obligations in these agreements and in other items of this disclosure document.12

Item 11: Except as listed below, [the franchisor] is not required to provide you with any assistance.13

Item 17: 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.14

Finally, the Compliance Guide notes that, “[i]f literal compliance with a particular disclosure requirement would result in confusing, misleading, or unclear information, additional clarifying footnotes are permitted.”15 Franchisors typically use footnotes, for example, to explain multiple ownership changes in the table in Item 20 and to provide more information for initial investment expenditures in Item 7 or ongoing fees in Item 6. These explanatory footnotes afford franchisors an opportunity to provide more information that may not be technically required by the FTC Rule but is used to tell the story of what is going on with the franchise system.

Practitioners should be aware that many states also have general requirements for FDD drafting. The requirements may be set forth in state regulations or in policy statements.16 In many instances, these general requirements limit the ability of practitioners to prepare and present an artful FDD; however, working within the bounds of these requirements it is possible to present the required data in a manner that is favorable to the franchisor and the franchise system and that permits the FDD to be used as a sales tool.

For example, state law may limit the ability of the franchise agreement to dictate the choice of forum and law for any suits arising from the agreement. In Items 17(v) and 17(w), practitioners disclose the choice of forum and choice of law in the agreement, and will often include a short statement indicating that these clauses are subject to state law. Where a state requires more disclosures in Item 17, practitioners should consider including the additional disclosures in a state-specific addendum to the FDD. By doing this, practitioners include the required information as part of an exhibit to the FDD and keep such information out of the main

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12 Id. § 436.5(i).
13 Id. § 436.5(k).
14 Id. § 436.5(q).
15 Id.
Item 17. This reduces potential confusion by readers not affected by the state requirements, while still providing such information in a clear and concise way for franchise sales governed by that state’s laws.

B. Cover Pages

The cover page explains to prospective franchisees the purpose of the FDD, basic information about the franchise system and certain protection mechanisms that have been put in place for franchisees. On the cover page, the FTC Rule requires franchisors to provide certain scripted language and other information in a required order and form. From the capitalized and bolded title to the prescribed language, the FTC has heavily regulated the disclosure requirements for the cover page. For example, the FTC Rule requires the title of the FDD - “FRANCHISE DISCLOSURE DOCUMENT” – to appear in both capital letters and boldface type. This title must be followed by basic information about the franchisor (i.e., name, type of business organization, principal business address, telephone number, and, if applicable, the franchisor’s email address and the address of the franchisor’s web page), and include the primary business trademark for the franchise system, a brief description of the franchised business, and a required statement referencing the range of fees disclosed in Items 5 and 7. Certain other prescribed statements must also be provided on the cover page, including:

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.

[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].

The terms of your contract will govern your franchise relationship. Do not rely on the disclosure document alone to understand your contract. Read your entire contract carefully. Show your contract and this disclosure document to an advisor, such as a lawyer or an accountant.

18 Id.
19 Id. § 436.3(a).
20 Id. § 436.3(b).
21 Id. § 436.3(c).
22 Id. § 436.3(d).
23 Id. § 436.3(e)(1).
24 Id.
25 Id. § 436.3(f).
26 Id. § 436.3(e)(3).
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, DC 20580. You can also visit the FTC’s home page at www.ftc.gov for additional information. Call your state agency or visit your public library for other sources of information on franchising.27

There may also be laws on franchising in your state. Ask your state agencies about them.28

Finally, the cover page must include the issuance date for the FDD on the cover page.29 According to the Compliance Guide, the “issuance” date should be the date on which the franchisor finalizes the FDD.30 However, states that review and approve an FDD typically refer to the “effective date” as the date on which they approve the FDD.31 In accommodating this state practice, the Compliance Guide notes that franchisors that obtain effective dates from registration states may use the term “effective date” on the cover page even in non-registration states.32 This lengthy list of cover page requirements creates the science behind this particular part of the FDD.

As the majority of the cover page is filled with prescribed language, there is relatively little room for the art behind FDD drafting here. Despite this, there are still a few choices that a practitioner may make to individualize the FDD, such as whether to include optional prescribed language. Practitioners also have the freedom to decide how large to make the sample of the trademark and how to briefly describe the franchise system.

In addition to the federal requirements, states may require additional information to be disclosed in the FDD. The cover page is no different. The Compliance Guide states that so long as the required state-specific disclosures are not inconsistent with the FTC Rule, the required state disclosures can be presented in the body of the FDD or in an amendment to the FDD or agreements.33 Specifically, this often comes up when state franchise examiners request franchisors to provide risk factors on the state cover page. Inclusion of these requested risk

27 Id. § 436.3(e)(4).
28 Id. § 436.3(e)(5).
29 Id. § 436.3(e)(6).
33 Id.
factors (and other information) will not violate the prohibition on providing information not required by the FTC Rule as long as the additional disclosure is required by state law or the franchisor can demonstrate that a state examiner requested the additional disclosure. However, franchisors should not include additional or modified risk factors that are not required by the FTC Rule or state law or requested by state examiners. Some states are more flexible than others when it comes to where a franchisor must or may include additional disclosures required by that state. If the states give the choice, practitioners may have some flexibility to decide where to put the required state-specific disclosures. Such flexibility enables the practitioner to artfully choose where the disclosure of such additional information would best serve the interest of the franchise system.

C. Table of Contents

The titles of the 23 Items in the FDD, which form the table of contents for the FDD, are prescribed in the FTC Rule. A franchisor cannot vary these Item titles. Other than being able to attach additional exhibits to the FDD, the table of contents is much more of a science than an art. In fact, the table of contents is so much a science that the Compliance Guide goes so far as to note that the exhibits should be referenced using letters (rather than numbers). As in other heavily regulated parts of the FDD, there is little room for artistic approach to producing a table of contents for use in an FDD.

D. Item 1

Item 1 gives prospective franchisees an overview of the franchise opportunity and the franchisor. In this Item, the franchisor explains the type of business the franchisee will operate. In addition to a summary of the franchisor’s own business background, franchisors must provide a summary of the business backgrounds of certain affiliated companies, all parent companies, and/or all predecessor companies. To provide an even fuller picture of the franchisor’s background, a franchisor must also discuss whether the franchisor or any affiliates, parents, or predecessors operate any of the franchised businesses or offer franchises for any other line of business. If these entities do either of those things, the franchisor must disclose the length of time each entity has conducted business under the franchise system, has offered franchises under the franchise system, and/or has offered franchises in another line of business. For entities offering franchises in other lines of business, the disclosure must also include a description of the other franchise system(s) and the number of franchises sold under

34 See id.
35 Id. at 27 - 28.
36 Id. at 27.
37 See 16 C.F.R. § 436.5(a); Compliance Guide at 29 - 32.
38 16 C.F.R. § 436.5(a)(6).
39 See id. § 436.5(a).
40 Id. § 436.5(a)(7).
41 Id.
the other system(s).\textsuperscript{42} Also in this Item, franchisors reveal any other business activities in which they engage.\textsuperscript{43} Item 1 requires the disclosure of some other general information - a brief explanation of the laws regulating the industry of the franchised business and the general market and competition that a franchisee should expect to face.\textsuperscript{44}

This Item provides an opportunity to describe the franchised business in the light most favorable to the franchisor. Franchisors often perceive that prospective franchisees are likely to review this Item more carefully than other Items. So, when drafting this Item, many franchisors tailor their language to present as much information as possible and try to tell their story in such a way as to assist the franchise sales force. Franchisors should avoid the temptation to put extraneous information that is not required by Item 1, but that the sales team may request be included. This type of information may be viewed as sales materials by the state franchise examiners, who are very likely to request that it be removed from the FDD.

E. Item 2

Prospective franchisees are able to get an inside glance at the business experience of the franchisor’s management team in Item 2 of the FDD. Franchisors must disclose 5 years of primary employment history for the “directors, trustees, general partners, principal officers, and any other individuals who will have management responsibility relating to the sale or operation of franchises.”\textsuperscript{45}

Some practitioners attempt to provide more than 5 years of biographical information on the individuals disclosed in this Item, as a way of highlighting that individual’s accomplishments. However, many state examiners have rejected this artful approach and have required practitioners to remove any employment history that predates the 5 year requirement. Trying to include additional information in Item 2 is likely to delay the FDD registration process. Franchisors with a small executive team may try to include as many individuals as possible in Item 2 to make the franchisor appear to have a more robust internal structure. The caution here is that, in addition to being potentially misleading, disclosures must be made in Items 3 (litigation) and 4 (bankruptcy) for each person listed in Item 2; therefore, careful consideration should be given to who is included in Item 2.

F. Item 3

Franchisors must disclose certain types of litigation going back for a period of 10 years in Item 3.\textsuperscript{46} For each action, the practitioner must develop a description that includes “the title, case number or citation, initial filing date, the names of the parties, the forum, and the relationship of the opposing party to the franchisor.”\textsuperscript{47} The write-up must also contain a factual

\begin{itemize}
\item \textsuperscript{42} Id.
\item \textsuperscript{43} Id. § 436.5(a)(6)(ii).
\item \textsuperscript{44} Id. §§ 436.5(a)(6)(iv)-(vi).
\item \textsuperscript{45} Id. § 436.5(b).
\item \textsuperscript{46} See id. § 436.5(c).
\item \textsuperscript{47} Id. § 436.5(c)(3).
\end{itemize}
and legal summary of the claims, “the relief sought or obtained, and any conclusions of law or fact” that came out of the action.\textsuperscript{48} The FTC Rule requires additional disclosures specific to the status of the action or the type of relief sought.\textsuperscript{49} For example, franchisors must state the status of pending actions or provide the judgment date along with a description of the holding, damages, or settlement terms for finalized actions.\textsuperscript{50} The summary must disclose the nature of any currently effective injunctive or restrictive orders.\textsuperscript{51} Any criminal convictions or pleas must be provided, along with the name of the crime, conviction date, and sentence.\textsuperscript{52} For civil actions involving the franchise relationship initiated by the franchisor, franchisors must disclose these actions for a one year period and the multiple actions may be listed under common headings.\textsuperscript{53}

Practitioners have relative flexibility in how they draft the description of any action disclosed in Item 3 so long as they meet all disclosure requirements. One common approach to improve the appearance of the franchisor in these descriptions is to use adjectives or clauses highlighting that the franchisor is “vigorously” prosecuting or defending a claim; however, some state examiners may request that these descriptors be revised or even removed. In describing the litigation matter, the franchisor should be mindful of the requirement to use plain English. Legal jargon in Item 3 must be avoided and, where that is not possible, the legal terms should be explained. In terms of organizing Item 3, franchisors with a number of actions that must be disclosed typically organize this Item in categories, such as concluded litigation, pending litigation and litigation filed by franchisor in last fiscal year. The last heading of cases can be separated into categories like suits to collect royalty fees, suits to enforce system standards, and suits to enforce restrictions on competition. On the artful side, the franchisor should consider how the litigation matters may be perceived by prospective franchisees and attempt to use descriptive language and categories to present the matters in as favorable a manner as possible. For example, matters filed by the franchisor against franchisees for royalty collection or post-termination infringement can be categorized together with a statement to demonstrate that the franchisor filed such actions to protect its brand and the franchise system. Although the thought of pending litigation (regardless of its purpose) may scare off potential franchisees, some litigation may in fact be helpful to the system. By clearly describing the purpose of the litigation, franchisees will have a better understanding of how any litigation may impact their investment and the franchise system as a whole.

Keep in mind, there is a prescribed negative disclosure if there are no litigation matters to disclose, and so little need for artful drafting.

G. Item 4

Item 4 gives prospective franchisees insight into the financial stability of the franchisor and its management team disclosed in Item 2. Under this Item, franchisors must disclose

\textsuperscript{48} Id.
\textsuperscript{49} Id.
\textsuperscript{50} Id. §§ 436.5(c)(3)(i)-(ii).
\textsuperscript{51} Id. § 436.5(c)(3)(iii).
\textsuperscript{52} Id. § 436.5(c)(3)(iv).
\textsuperscript{53} Id. §§ 436.5(c)(1)(ii), (4).
certain domestic and foreign bankruptcies within the past 10 years faced by the franchisor, its affiliates, parents, predecessors, or members of its management team. Where a bankruptcy must be disclosed, the following must also be provided: (1) the name, address, and principal place of business of the debtor; (2) the relationship of the debtor to the franchisor; and (3) a summary of the bankruptcy proceeding including the original filing date, material facts, name of the bankruptcy court, case name and number, and the debtor's discharge date, if applicable.

Similar to the descriptions in Item 3, provided that all required information is disclosed, practitioners have flexibility to artfully mold their descriptions of such bankruptcies to minimize the negative connotations associated with such disclosure. For example, for personal bankruptcies, the disclosure can provide a description of the context under which the bankruptcy was filed. For bankruptcies filed by unrelated companies where an executive of the franchisor previously worked, the disclosure should identify the executive’s role with the other company and explain the executive’s role in the financial management of the company and the bankruptcy filing. These explanations often help soften the impact of such filings in the minds of a reasonable prospective franchisee.

Keep in mind, as in Item 3; there is a prescribed negative disclosure if there are no bankruptcy matters to disclose.

**H. Item 5**

Fees are important in deciding to go into any business venture, and franchising is no different. Item 5 is the first of several Items in the FDD that discloses the various types of fees that a franchisee will be expected to pay in opening and operating the franchise. Item 5 discloses the initial fees that a franchisee will pay or make a commitment to pay to the franchisor or its affiliate before opening the franchised business. For each initial fee, the franchisor must indicate whether the fee is refundable and/or uniform. Where the fee is not uniform, the franchisor must explain the range or formula used over the previous fiscal year to calculate the fee amount and the factors used to determine the amount.

Beyond strict compliance with the disclosure requirements, there is a good bit of art that goes into drafting Item 5. Here, the best strategy is likely to be, keep it simple. State the fees that are required to be paid before opening in a chronological order. For example, if the franchisor requires payment of a deposit, development fee and initial franchise fee, disclose the fees in the order the franchisee will pay the fees, under separate subheadings for each fee, and note whether any fee is credited against other fees or is refundable. While it might be tempting to bog this Item down with additional information about things like the amount of training or opening support the franchisee receives in consideration for the fees paid, that is not required, is likely to generate a comment from the state administrators and may be confusing for franchisees reviewing the FDD.

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54 *Id.* § 436.5(d)(1).

55 *Id.* § 436.5(d)(2).

56 *Id.* § 436.5(e).

57 *Id.*

58 *Id.*
As this Item is drafted, careful attention must be paid to ensure that it covers all fees, charges and amounts paid to the franchisor and its affiliates prior to opening of the franchised business. Franchisors sometimes forget to include charges for things like training fees, product or inventory, and marketing materials. In reviewing the Items of the FDD for consistency and to be sure that this Item accurately reflects all amounts charged, the franchisor should check that all fees noted in Item 7 as paid to the franchisor or its affiliate as part of the initial investment are reflected in Item 5. Conversely, the same is true, and any fees listed in Item 5 should be identified as an upfront expenditure in Item 7 (as explained in further detail below). This gives a franchisor a convenient way to double check both Items 5 and 7, assuming that a fee is not improperly omitted from both Items.

Finally, this Item requires franchisors to “disclose the range or formula used to calculate the initial fees paid in the fiscal year before the issuance date and the factors that determined the amount”^59 if the franchisor did not charge uniform fees. So, for each fiscal year, the franchisor must track the amount of initial fees paid by each new franchisee and, if those franchisees paid an amount that is different from that stated in Item 5 of the FDD received, the franchisor must disclose (in the following year’s FDD) the fee variation and the factors that went into the decisions to provide fee variations. While there are many ways to present these fee variations, three examples are:

- During our last fiscal year, new franchisees paid an initial fee that ranged from $10,000 to $50,000. Certain franchisees paid a lower fee because they were opening franchises in markets that we currently do not have franchisees in or because they committed to develop multiple franchised businesses in a short period of time.

- During our last fiscal year, new franchisees paid us Initial Franchise Fees ranging from $21,444.80 to $48,288.80. This amount varies because it is based upon the number of designated households in the franchisee’s territory. Franchisees pay $1.10 per designated household.

- During our last fiscal year, we sold 3 new franchises. While our standard franchise fee is $35,000, our new franchisees paid the following franchise fees: food court in shopping mall - $15,000; traditional pad site outside shopping mall - $35,000 and in-line location - $25,000.

In drafting the disclosure about fee variations, keep in mind the technical requirements and also how the disclosure may be perceived by prospective franchisees. This disclosure might be one that would benefit from review by the franchise sales team, which will likely have greater insight into how prospective franchisees will react to reading about such fee variations.

I. Item 6

Other fees that the franchisee pays to the franchisor or its affiliates (or that the franchisor or its affiliate impose or collect for a third party) are summarized in a tabular form in Item 6. The FTC Rule provides the template for the Item 6 table which breaks the description of each

^59 Id.

^60 See id. § 436.5(f).
fee into 4 columns. The first column provides a title for the fee.61 The second column discloses the amount of the fee.62 The third column discloses the due date of the fee.63 The fourth column provides the practitioner with space to include additional explanatory comments on the fee.64

In certain circumstances, the FTC Rule requires the franchisor to include a note in the remarks column or a footnote for additional comments. Such additional comments are: (1) whether the fees are paid only to the franchisor; (2) “whether the fees are imposed and collected by the franchisor;” (3) whether the fees are refundable and if so in what circumstances; (4) “whether the fees are uniformly imposed;” and (5) whether franchisor owned outlets have voting power on cooperative fees and if they have controlling voting power, then whether there are maximum and minimum amounts that can be imposed.65 In addition, state examiners often request that franchisors add additional descriptive language in the remarks column for certain fees.

Although the pre-established structure of the table in Item 6 may make Item 6 appear too rigid to allow for artful presentation of the information, there are a few ways that a practitioner may tailor Item 6. Where the practitioner wishes to include even greater information on a particular (or even multiple) fee(s), some practitioners will reference a footnote that they include at the end of Item 6. This is particularly helpful where additional remarks are relevant to multiple fees. The FTC Rule requires franchisors to disclose whether the fees outlined in Item 6 are applied uniformly, and practitioners may use footnotes as an opportunity to explain the rationale behind the variation in the amount of the fee for any fee that is not uniform.

Just like with Item 5, careful attention should be given to ensure that Item 6 covers all possible fees, charges and amounts a franchisee may be required to pay to the franchisor, its affiliates or a third party during the course of the franchise relationship. Some smaller fees, such as website maintenance fees, or fees that only become due upon certain triggers, such as additional training fees and attorneys’ fees, may be easy to overlook, but need to be included in Item 6. Franchise examiners often check this Item against the agreements to determine if all fees are included. Also, in instances where the fees are to be determined later by the franchisor or the franchisor has the ability to increase the fees, franchise examiners may require the FDD to state a range of the amount that will be charged if determinable.

As a final check, the franchisor should review Items 5 and 6 to ensure that Item 5 covers the pre-opening fees and Item 6 covers the post-opening fees. State franchise examiners will review this and, if there is unnecessary overlap or the fees are not disclosed in the correct Item the examiners will require revisions.

61 Id.
62 Id. § 436.5(f)(2).
63 Id. § 436.5(f)(3).
64 Id. § 436.5(f)(4).
65 Id. §§ 436.5 (f)(4)(i)-(v).
J. **Item 7**

Item 7 provides the franchisor’s estimate of the initial investment costs the franchisee will incur to open the franchised business.\(^{66}\) Similar to Item 6, the format for Item 7 is prescribed by the FTC Rule, which breaks this disclosure into a 5-columned table.\(^{67}\) Here, the first column lists the type of expenditure.\(^{68}\) The second column indicates the amount of the expenditure.\(^{69}\) The third column describes the required method of payment.\(^{70}\) The fourth column is dedicated to explaining when the payment is due.\(^{71}\) Finally, the fifth column provides to whom the payment is made.\(^{72}\) The franchisor must disclose in Item 7 all estimated pre-opening expenses for the relevant franchise system.\(^{73}\) The FTC Rule provides a list of possible expenditures that, if present in the franchise system, must be disclosed, which include:

- “The initial franchisee fee;
- Training expenses;
- Real property, whether purchased or leased;
- Equipment, fixtures, other fixed assets, construction, remodeling, leasehold improvements, and decorating costs, whether purchased or leased;
- Inventory to begin operating; and
- Security deposits, utility deposits, business licenses, and other prepaid expenses.”\(^{74}\)

The franchisor should carefully consider the opening costs associated with the franchise system and include any additional pre-opening expenditure that the franchisee must make outside of the list provided by the FTC Rule. Additionally, the FTC Rules require the franchisor to include an expenditure under the title “Additional Funds” that indicates an estimated amount of additional money that the franchisee will need in order to operate the franchised business during the initial period.\(^{75}\) For this particular expenditure, the franchisor must spell out the length of time the franchisor estimates the initial period to last and explain the factors the franchisor

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\(^{66}\) See id. § 436.5(g).

\(^{67}\) See id.

\(^{68}\) Id. § 436.5(g)(1).

\(^{69}\) Id. § 436.5(g)(2).

\(^{70}\) Id. § 436.5(g)(3).

\(^{71}\) Id. § 436.5(g)(4).

\(^{72}\) Id. § 436.5(g)(5).

\(^{73}\) See id.

\(^{74}\) Id. § 436.5(g)(1)(i).

\(^{75}\) Id. § 436.5(g)(1)(ii).
considered in making its estimate. This expenditure is unique because it is the only expenditure in Item 7 that includes estimated costs during the initial period. The other expenditures are limited to pre-opening costs.

Similar to Items 5 and 6, the FTC Rule requires the franchisor to indicate whether each expenditure is refundable, and if so, under what circumstances. Where the franchisor or its affiliate finances any part of the initial investment, the franchisor must provide some information on the financing, such as the down payment, interest rate, factors of the interest rate, and estimated loan repayment schedule.

As the franchisor prepares Item 7, it is important to keep in mind how prospective franchisees will use this Item. A diligent prospective franchisee will take Item 7 along with other information provided by the franchisor to its business advisors and lenders to review and set up financial modeling for start-up costs. So, there is some art in deciding what amounts to disclose in each expenditure category. The FTC Rule permits the franchisor to state the amount of each expenditure as a low – high range if the exact amount of the expenditure is not known. This is an acknowledgement of the reality that franchisors are unlikely to be able to state an exact amount of certain expenditures – such as opening inventory, signage, equipment, and build out costs. If possible, the ranges should be based upon actual experiences of franchised or company-owned businesses that have opened. Then, the footnotes should describe any assumptions underlying the expenditure range. For example, if the range assumes a certain amount of opening inventory will be purchased or a specific list of equipment, that information should be clearly disclosed in the notes. If the expenditures are likely to vary by geographic area or by trade area, that should be disclosed. Some expenditures are very difficult to estimate, such as real property and liquor license costs. In these instances, franchisors may be permitted to state that the fees are “variable” in the Item 7 table and use the notes to explain some factors that are relevant to these costs that will help the prospective franchisee review the relevant market or area and come up with a cost range for the line Item – such as the size and location of the property or how the liquor license may be obtained in various jurisdictions.

Some franchise systems offer different types of franchised outlets – for example, restaurant franchises may be located in traditional sites, in-line sites, and mall sites. In this case, assuming the franchisor is offering franchises for all of the various types of venues and has sufficient reliable opening cost data on the various venues, the franchisor should consider how to present the estimated initial investment information for Item 7. In some instances, combining the data into one chart for different types of venues may be misleading – for example if the costs for a mall location are significantly lower than the costs for a stand-alone pad site. Presenting the data in three separate Item 7 tables – one for each type of venue – may be the best practice in this instance. Each table must be carefully identified and the notes should

76 Id.

77 Compliance Guide at 49.

78 Id.

79 16 C.F.R. § 436.5(7)(i).

80 Id. § 436.5(g)(7)(ii).

81 Id. § 436.5(g)(2).
reflect the variances between the venues. The other option is for the franchisor to use one chart for the type of venue that is most frequently offered (or the type of venue the franchise system is trying to sell) and put the fee variance for the other venues in the notes with explanations.

Finally, as noted in the discussion of Item 5, it is good practice to cross check the references in the “To Whom Payment Is To Be Made” in Item 7 against Item 5. Any amount that shows as due to the franchisor or its affiliates in Item 7 should be included in Item 5.

K. Item 8

Many franchise systems restrict the sources from which a franchisee can obtain certain products and services. This is addressed in Item 8, where franchisors must disclose any restrictions that franchisors have on the source of products and services, such as products and services that must be purchased from the franchisor, a supplier approved by the franchisor, or another supplier that meets the franchisor’s specifications. For each such restriction, the franchisor must explain what the franchisee must buy or lease, whether the franchisor or its management team have any interest in the required purchase, the process the franchisor follows in selecting approved suppliers and how the franchisor may revoke approval, what standards the franchisor uses (if they share this information), and the estimated proportion of required purchases the franchisee will need to make in both opening and operating the franchised business. The franchisor must also reveal whether there are any purchasing cooperatives, whether the franchisor negotiate any purchase terms with suppliers, and whether the franchisor gives any material benefit to franchisees that purchase from a particular supplier. The franchisor must disclose information on any revenue or rebates the franchisor receives based on required purchases by their franchisees.

For franchisors, the restrictions on sources of supply for a franchise system form the cornerstone of controlling the look and feel of franchised businesses. In addition to disclosing the technically required Items, franchisors can disclose the reason for the requirements. The disclosures should be written in a manner that emphasizes the important role that the restrictions disclosed in Item 8 play in protecting the franchise system by establishing quality requirements, and in turn protecting the prospective franchisee’s potential investment.

L. Item 9

Item 9 serves as an index that enables prospective franchisees to easily find: (1) the contractual language that governs the franchisee’s obligations under the franchised relationship in the franchise or other relevant agreements; and (2) the summaries of these obligations within

82 See id. § 436.5(h).
83 Id. §§ 436.5(h)(1),(3)-(7).
84 Id. §§ 436.5(h)(9)-(11).
85 Id. § 436.5(h)(8).
the FDD itself.87 This Item is specifically prescribed by the FTC Rule. For example, Item 9 must begin with the following mandatory statement in bold:

This table lists your principal obligations under the franchise and other agreements. It will help you find more detailed information about your obligations in these agreements and other items of this disclosure document.88

Then, the required table must include three pre-established columns.89 The first column provides a pre-set list of the franchisee’s obligations.90 The list of obligations cannot be changed; and for any obligation that is not included in the franchise agreements or FDD, the franchisor must merely state “Not Applicable” in the table.91 Franchisors can disclose additional obligations that are relevant to the franchise system under a category labeled “Other” at the end of the table.92 The second column indicates where the contractual language discussing the franchisee’s obligation is located in the relevant agreements.93 The third column indicates where the franchisee’s obligation is discussed within the FDD.94

There is little room for artful drafting in Item 9. Franchisors merely fill in the blanks in the second and third columns. However, franchisors do have some stylistic choices when a franchise system involves multiple relevant agreements (such as a supply agreement, development agreement and a franchise agreement). Where there is more than one relevant agreement underlying the franchise relationship, some practitioners will develop a separate table for each agreement or combine the agreements into one table. Either way is acceptable.

M. Item 10

The purpose of Item 10 is to reveal whether or not the franchisor, its affiliates, or its agents offer any direct or indirect financing to the franchisee.95 Where the franchisor does not offer any financing arrangements, practitioners must make a negative disclosure stating that the franchisor does not offer any financing.96 For example:

87 See 16 C.F.R. § 436.5(i).
88 Id.
89 See id.
90 Id.
91 Id.
92 See id.
93 See id.
94 See id.
95 Id. § 436.5(j)(1).
96 See Compliance Guide at 121.
• We do not offer direct or indirect financing, and we do not guarantee your notes, leases or other obligations.

• We do not offer direct or indirect financing of your initial franchise fee. We do not receive any direct or indirect payments for financing you might obtain. We will not guarantee any financing you might obtain.

Where a franchisor offers financing directly or indirectly to the franchisee, the disclosure must explain what the financing arrangement covers, as well as whom the lenders are and what their relationship is to the franchisor. The mechanical components of the financing arrangement must also be provided, such as the amount of the financing offered, the rate of interest, the number of payments or repayment period, pre-payment options, penalties, and any other material terms to the financing. If the financing arrangement requires the franchisee to waive legal rights, then this must be stated in Item 10. The franchisor must also explain whether the franchisee must provide any security for the loan and/or sign a personal guaranty for the financing. Lastly, the franchisor must explain if the franchisor intends to transfer the financing arrangement and/or if the franchisor receives any benefit for placing financing with another lender. Where the answer is yes to either of these questions, then the franchisor must go into greater detail on these points.

In regards to the art of creating an Item 10 disclosure, practitioners have great flexibility in how they wish to present the required information. The FTC Rule expressly allows for practitioners to format Item 10 disclosures in a tabular format and even provides an example table in an appendix to the rule. However, practitioners do not have to provide this information in a tabular form. Careful attention must be given to ensure that all required information is disclosed and that, if a table is used for the disclosures, notes are used to explain the information disclosed. Additionally, specimen loan documents should be referenced in Items 10 and 22 and attached as an exhibit to the FDD.

If a franchisor is on the SBA Registry, some practitioners will include a statement similar to the following in the FDD:

• We are listed on the SBA’s Franchise Registry Program. Under this program, if you have an SBA guaranteed loan, your lender will be able to use an expedited and streamlined SBA loan processing through the SBA’s Franchise Registry Program, www.franchiseregistry.com.

98 Id. §§ 436.5(j)(1)(ii)-(x).
99 Id. § 436.5(j)(2).
100 Id. §§ 436.5(j)(1)(vi), (vii), (ix).
101 Id. §§ 436.5(j)(3)-(4).
102 See id.
103 Id. § 436.5(j)(1).
Although this information can be useful to a prospective franchisee and helpful as a sales tool to the franchisor, it is not a required disclosure. Under a strict interpretation of the FTC Rule, state examiners may ask the franchisor to remove such a statement because it is not technically required.

N. Item 11

1. General Pre- and Post-Opening Obligations

Item 11 covers the many forms of assistance that the franchisor will provide to the franchisee over the course of the franchise relationship. The franchisor must disclose its pre-opening and ongoing obligations to the franchisee, and provide references to the section in the relevant agreement that establishes each such obligation. The FTC Rule provides a list of possible obligations that the franchisor may undertake as a guideline for starting this disclosure. The franchisor is not required to include these examples if they are not relevant to the franchise system. The FTC Rule provides specific required language to disclaim that the franchisor must provide any additional assistance to the franchisee than what is set out in Item 11: “Except as listed below, we are not required to provide you with any assistance.” Practitioners typically list these obligations in numbered paragraphs that follow the order of the obligations in the franchise agreement.

After this initial listing of the franchisor’s general pre-opening and post-opening obligations, greater information is required for certain types of assistance. The franchisor must describe certain obligations relating to locating a site for the franchised business, such as whether the franchisor leases the site to the franchisee, whether the franchisor selects the site or approves an area in which the site must be located, the factors the franchisor considers in approving sites, and any time limit for the franchisor to approve sites and the consequences of failure to identify a site. Then, the franchisor must provide an estimated range for the length of time it takes between signing the franchise agreement and opening the franchised business and describe any factors that impact this time frame.
ii. Advertising

Franchisors must also describe requirements for the franchise’s advertising programs including:

- The franchisor’s obligation to conduct advertising, the media that is used, whether the coverage will be national, regional or local, the source of the advertising materials and whether the money contributed by individual franchisees will be spent in the franchisee’s local area;
- Whether the franchisor permits franchisees to use their own advertising materials and any restrictions on this ability;
- Whether the franchise system has an advertising council and if so certain information about the members of the council and its role in advertising decisions; and
- The franchisee’s obligation to participate in cooperatives or other marketing funds and certain information about the various funds.\textsuperscript{112}

iii. Technology

Next, the franchisor must disclose certain general information about the required computer or point-of-sale systems. The disclosure must include – the cost of the systems, any obligation of the franchisor to provide ongoing support or maintenance, any obligation for the franchisee to upgrade or replace the system including contractual limitations on this obligation, the annual cost of updates and maintenance, and whether the franchisor has independent access to the information stored in the franchisee’s computer systems.\textsuperscript{113} Franchisors should pay careful attention to this disclosure as it is specifically required to be made in “non-technical language.”\textsuperscript{114}

iv. Training

Going into greater depth on the training program, the FTC Rule requires the franchisor to provide a pre-set 4-columned table outlining the subjects of the training program, the hours of classroom training, the hours of on-the-job training and the location of the training.\textsuperscript{115} After the table the franchisor must also disclose how often training classes are held and the nature of the training facility, the instructional materials provided and the instructors’ relevant training experience, any fees due for training and who pays costs associated with attendance, who is required to attend the training programs, and whether, after the initial training is completed, additional or refresher training is required.\textsuperscript{116}

\textsuperscript{112}Id. § 436.5(k)(4).
\textsuperscript{113}Id. § 436.5(k)(5).
\textsuperscript{114}Id.
\textsuperscript{115}Id. § 436.5(k)(5)(i).
\textsuperscript{116}Id. § 436.5(k)(5)(ii).
v. Manual Table of Contents

A table of contents of the operations manual must be included in the FDD.\textsuperscript{117} The franchisor must disclose the number of pages devoted to each subject in the manual and the total number of pages in the manual.\textsuperscript{118} As franchisors move towards alternative means, such as electronic manuals or web-based manuals, these disclosure obligations may become more difficult to satisfy. For example, web-based manuals may not have “page numbers.” In this situation, franchise examiners have required franchisors to count numbers of screens for each subject or to print the materials and count the printed pages to satisfy this disclosure requirement. Practitioners may be tempted to include a link in the FDD to the table of contents, but should do so carefully. Internal links that bring a reader to another part of the same document are allowed.\textsuperscript{119} However, external links that bring a reader to another document (other than the FDD itself) are expressly prohibited.\textsuperscript{120} Franchisors that permit prospects to review the operations manual before buying the franchise opportunity under the terms of confidentiality agreement do not need to include the disclosures for the manuals, but must include the form of confidentiality agreement that must be signed.\textsuperscript{121}

For most franchise systems, since Item 11 is required to include a significant amount of information on a variety of important system topics, Item 11 becomes one of the longest and densest Items of the FDD. Franchisors work towards providing this information in a clear and concise way that is easy for prospects to understand. For example, many franchisors organize this Item using subheadings for each category of disclosure and then present the information by category chronologically. This Item also lends itself to presenting information in charts or lists if possible. Also, keeping this Item simple and avoiding cross references to other Items is important. For example, practitioners may be tempted to simply cross reference Item 2 for the experience of the training instructors; however, the disclosure in Item 11 is a streamlined biography, which should only list the instructor’s length of experience in the field and with the franchisor. Accordingly, franchisors should fight the urge to simply cross reference other sections, and instead provide clear and concise language speaking directly to the disclosures required in Item 11.

O. Item 12

For many franchised businesses, location, location, location is one of the keys to success. Then, the next key for the location will be what rights are granted to the franchisee and what rights are reserved to the franchisor. Item 12 informs prospective franchisees about the location and possible territory of the franchise opportunity.\textsuperscript{122} Franchisors are required to disclose whether franchises are sold for specific locations or locations that must be approved by

\textsuperscript{117} Id. § 436.5(k)(6).

\textsuperscript{118} Id.

\textsuperscript{119} Compliance Guide at 19.

\textsuperscript{120} Id.

\textsuperscript{121} Compliance Guide at 67.

\textsuperscript{122} 16 C.F.R. § 436.5(l).
the franchisor.\textsuperscript{123} The disclosure must explain the minimum territory that will be granted to the franchisee, and what restrictions are placed on both the franchisee and the franchisor in that territory.\textsuperscript{124} Because there is wide room for interpretation of the term “exclusive,” the FTC Rule requires the franchisor to use specific language and additional clarifications when discussing whether the territory provided to the franchisee is exclusive. If the territory includes typical reserved rights for the franchisor or other third parties, the franchisor must include the following mandatory statement:

You will not receive an exclusive territory. You may face competition from other franchisees, from outlets that we own, or from other channels of distribution or competitive brands that we control.\textsuperscript{125}

This Item requires franchisors to disclose whether the franchisor can solicit orders from within the franchisee’s territory and whether the franchisor pays franchisees any compensation for orders from within the franchisee’s territory. Also, the franchisor must state whether the franchisor reserves the right to use alternative channels of distribution within the franchisee’s territory.\textsuperscript{126} Lastly, the summary must identify any conditions on the franchisee for relocating the franchised business or for establishing additional locations, as well as any additional rights that will be granted to the franchisee, such as options of first refusal.\textsuperscript{127}

This Item is critical to franchisees. A variety of factors can make this disclosure more complicated than it should be. For example, franchisors may use terms of art or legal jargon to describe the territory that is granted. When that is the case, prospects who are new to franchising may find it difficult to understand what rights have been granted and what rights have been reserved. For example, franchisors often state that the territory is exclusive or limitedly exclusive. Without a clear understanding of these legal terms and any caveats or carve outs, the FDD language might be misleading. Then, even when the FDD reflects the grant and carve outs, it can be difficult for prospects to follow the language. Franchisors should strive to make this Item as clear as possible for the prospect.

P. Item 13

Like location, trademarks are extremely important in the context of franchise systems. This is the subject of Item 13.\textsuperscript{128} Franchisors must present each “principal trademark” that it will license to the franchisee for use in connection with the franchised business.\textsuperscript{129} For trademarks that are registered with the USPTO, the disclosure must include information on the specific registrations, such as the identification number.\textsuperscript{130} Where the franchisor licenses the use of

\textsuperscript{123} Id. § 436.5(l)(1).
\textsuperscript{124} Id. §§ 436.5(l)(2), (6).
\textsuperscript{125} Id. § 436.5(l)(5(i).
\textsuperscript{126} Id. § 436.5(l)(6)(ii).
\textsuperscript{127} Id. §§ 436.5(l)(3), (4).
\textsuperscript{128} See id. § 436.5(m).
\textsuperscript{129} Id. § 436.5(m)(1).
\textsuperscript{130} Id. § 436.5(m)(2).
trademarks that are not registered with the USPTO, the FTC Rule prescribes specific language to be included in this Item. To provide an idea of the rights and limitations of the franchisee’s use of these trademarks, the franchisor must reveal whether there are any holdings or agreements pending litigation or infringing uses that may affect the franchisee’s use of the trademarks. Where there are, the franchisor must provide additional information on these holdings, agreements, actions and/or uses. In addition, the franchisor must describe what actions it has taken and may be required to take by virtue of the franchise agreement to protect and maintain these trademarks. Franchisees must also be put on notice of their rights and obligations in regards to their use and the protection of the trademarks, such as whether the franchisee may modify the trademarks and whether the franchisee must notify the franchisor of any suspected infringing use of the trademarks.

Disclosure of the trademarks is important for prospects to see the value that the brand brings with it. The FTC Rule explicitly allows franchisors to include only the system’s principal marks, rather than all of the trademarks that the franchisor owns. This leaves practitioners room to pick and choose which trademarks to include in this Item. Typically, the FDD includes the trademark that is most closely associated with the system and then any other key trademarks that are used. Franchisors should keep in mind that if they go beyond including the principal marks and there is a dispute regarding such mark or an issue with the USPTO, that dispute or issue will need to be disclosed in the FDD. Having to disclose such additional information on secondary marks could result in the franchisor having to update the FDD when the franchisor would not have otherwise had to, which will be an added cost to the franchisor.

Q. Item 14

Item 14 is dedicated to the franchisor’s patents, copyrights, and proprietary information. In this Item, the franchisor discusses whether they have any rights or licenses to any such information. Where the franchisor owns or has applied for patents material to the franchise, the summary must include information on those applications. Similar to Item 13, the franchisor must reveal whether there are any holdings or agreements that limit the use of any patents or copyrights. The same is true for any pending litigation. The franchisor must also disclose any patent or copyright infringement that the franchisor is aware of that may affect the franchised business. Franchisors must also explain both the franchisor’s and the

131 See id. § 436.5(m)(4).
132 Id. §§ 436.5(m)(5)-(7).
133 Id.
134 Id. § 436.5(m)(8).
135 Id.
136 See id. § 436.5(n).
137 Id. §§ 436.5(n)(1)-(2).
138 Id. §§ 436.5(n)(2), (4).
139 Id. § 436.5(n)(3).
140 Id. § 436.5(n)(6).
franchisee’s rights and responsibilities in regards to protecting any patents or copyrights. 141 Lastly, if the franchisor claims any rights in other confidential information, then the franchisor must explain which information the franchisor claims protection over and how the franchisee may use that information. 142

Like trademarks, these other forms of intellectual property are a cornerstone to franchise systems. Franchisees will want to be part of a system that includes well documented systems, some of which may be subject to protection by copyright and patent law. The forms of intellectual property should be carefully explained to the prospect. To the extent that the franchisor has any restrictions in place to protect these rights, that should be disclosed.

R. Item 15

Different franchisors have different expectations for how much time they expect their franchisees to devote to personally managing the franchised business. This expectation is covered in Item 15. 143 The franchisor must disclose whether the franchisee has direct onsite management requirements. 144 Where the franchisor does not require the franchisee to personally manage the franchised business, Item 15 must summarize the franchisor’s recommendations and requirements for the management of the business. 145 This Item is key in assisting owners of the franchised business to determine what amount of their time must be devoted to the business. If the owners (or, if permitted, the other managers) are required to sign any agreements with the franchisor before the business opens (such as confidentiality agreements, non-compete agreements, guarantees), copies must be included as exhibits to the FDD. 146 Also, if the franchisor does not require personal management by the franchisee, the franchisor must disclose if managers of the business or onsite operators must have an equity interest in the business and if so, how much of an interest. 147 This Item is important to franchise owners and should be clear and concise. With regard to the restriction placed on owners and operators, for franchise systems that attempt to attract multi-unit operators and large net worth franchisees, some of these restrictions many not be feasible for the franchisees and operators. If the system ends up with varying requirements, the franchisor will need to assess what information should be disclosed in the FDD and bear in mind that if the franchisor negotiates changes for any particular franchisee, the franchisor will need to assess the impact on state requirements, such as California’s negotiated change rules.

141 Id. § 436.5(n)(5).
142 Id. § 436.5(n)(7).
143 See id. § 436.5(o).
144 Id.
145 Id. § 436.5(o)(2).
146 See Compliance Guide at 78 n.15.
147 16 C.F.R. § 436.5(o)(2)(iv).
S. Item 16

Franchisors may place limitations on what the franchisee may offer at their franchised business. These limitations must be disclosed in Item 16.148 For example, franchisors must state if the franchisee may sell only or all approved goods or services.149 Where these limitations exist, the franchisor must explain whether the franchisor may make changes to the list of approved goods and services and “whether there are any limits on the franchisor’s right to make changes.”150 This Item is fairly straightforward and can be set up to highlight how the control of these offerings help the franchise system maintain uniformity across the brand. Some art comes into drafting Item 16 disclosures to highlight the possible benefits these restrictions have for the entire franchise system, rather than focusing on these restrictions as limitations for individual operators.

T. Item 17

Item 17 provides another index to aid prospective franchisees in navigating the franchise agreement and other related agreements. The FTC Rule provides an introductory mandatory statement151 and then a table of key provisions in most franchise agreements, which cannot be modified, except that franchisors can supplement the chart with additional provisions.152 The franchisor must provide a reference to the sections of the franchise agreement (or related agreement) that cover the provision listed and summarize the agreement’s position on these topics.153 Where a concept is not a part of a particular agreement, the franchisor must write, “Not applicable.”154

Like Item 9, Item 17 is specifically prescribed. Despite the rigidity of the pre-established table, the summary column provides practitioners with room to go into greater detail on specific components of the agreement. This is where the art of Item 17 is evident. Practitioners differ on how they present the summaries – which run the gamut from merely paraphrasing the agreement language to a skeletal outline of the language. The summaries should be carefully reviewed to make sure that legal terms are defined, capitalized or defined terms from the agreement are defined in the FDD, and all relevant terms are summarized. If the agreements are silent regarding an enumerated provision, but the franchisor voluntarily offers to provide certain benefits or protections to franchisees as a matter of policy, that policy may be summarized in a footnote to Item 17. Finally, some states may require the summary under “Choice of Law” and “Choice of Forum” to be qualified with “subject to state law”. Additionally, some states look for language under the “Integration/Merger Clause” heading to indicate that

148 See id. § 436.5(p).
149 See id.
150 Id. § 436.5(p)(3).
151 The introductory mandatory statement for Item 17 follows, and it must appear in bold text: 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. Id. § 436.5(q).
152 See id.
153 See id.
154 Id. § 436.5(q)(1).
the agreement language does not waive the prospective franchisee’s right to rely on the representations that are made in the FDD. A common approach to including such language is to first describe the terms of the integration/merger clause in the agreement and then to state, “Nothing in the Franchise Agreement requires you to waive reliance on the representations we made in the disclosure document.”

U. Item 18

Where public figures are involved in the sale of the franchise, certain aspects of the relationship must be disclosed in Item 18. This Item must reveal: (1) any benefit given to a public figure for using their name or image in association with the franchise or for promoting franchise opportunities; (2) the role and duties of any public figure involved in the management of the franchise; and (3) how much the public figure has invested in the franchisor. Over the years, franchisors seem to be making less and less use of public figures in connection with the sale of franchises. Therefore, practitioners rarely are called upon to include a disclosure in this Item.

V. Item 19

Franchisors have the option of providing a financial performance representation (FPR). Whether the franchisor does or does not provide an FPR, the FTC Rule provides scripted language that must be included in Item 19. Where the franchisor does not provide an FPR, this is the end of Item 19. Where an FPR is provided, the FTC Rule enunciates requirements for creating an FPR. An FPR must be reasonable and the franchisor must be able to present a written account of the materials used in developing the FPR. Franchisors must warn prospective franchisees that individual results may vary and that prospective franchisees are entitled to ask for the data underlying the FPR. The franchisor must explain whether the FPR is about historical or future expected performance. For FPRs presenting historical performance of the franchise, the franchisor must reveal information about the pool of franchises and the methods used to calculate the representation. For FPRs forecasting performance, the franchisor must explain what facts and assumptions the franchisor took into account.

The artful inclusion of an FPR can be of particular importance for new or start-up franchisors, or really any franchisor whose trademarks and goodwill are not widely known. With these franchisors, prospective franchisees are likely going to want additional information to get a

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155 See id. § 436.5(r).
156 Id. §§ 436.5(r)(1)-(3).
157 See id. § 436.5(s).
158 Id. § 436.5(s)(3).
159 Id. §§ 436.5(s)(3)(iv)-(v).
160 Id. § 436.5(s)(3)(i),(iii).
161 Id. § 436.5(s)(3)(ii).
162 Id. § 436.5(s)(3)(iii).
better idea of what kind of return on investment they might be able to attain. This is likely even more important where a franchise system has relatively few franchisees, which limits the amount of information that a prospect would be able to obtain by reaching out directly to other franchisees under the system. However, providing an FPR creates an added risk for the franchisor because the historical data or forecasts must have a reasonable basis. Accordingly, FPRs should be presented along with ample information explaining the foundation for the data presented. Lastly, sometimes the art of drafting Item 19 is merely identifying whether a particular franchise system includes an FPR by virtue of the way that the franchise system has been structured. For example, there is an argument that, where a franchisor collects royalties on a variable basis that depends on the franchisees' sales and establishes a minimum royalty if a certain sales quota is not met; this is in and of itself an FPR. The particularities of each system may require an FPR, and so practitioners should be aware of such situations which would need to be disclosed in Item 19.\textsuperscript{163}

W. Item 20

Item 20 is a series of five tables that provides information about franchised and company-owned locations for the previous three fiscal years.\textsuperscript{164} In Table 1, franchisors provide an overview of franchised and company owned locations within the system. This table captures net overall change in the franchise system unit counts.\textsuperscript{165} Table 2 provides the number of franchised locations that have been transferred to new owners, broken down by state.\textsuperscript{166} Since a system with a high turnover rate may indicate areas for concern, franchisors may explain the transfers in the footnotes. Table 3 provides a summary, presented state-by-state of the status of franchised locations.\textsuperscript{167} The table includes the number of locations opened in each year, and also changes to the status of franchised locations, such as terminations, non-renewal, and reacquisitions by the franchisor.\textsuperscript{168} Similar to Table 3, Table 4 provides a state-by-state analysis for company owned locations.\textsuperscript{169} Lastly, Table 5 presents the franchise systems' expected growth by state for the upcoming fiscal year, disclosing the number of franchise agreements signed but units not opened, projected franchised openings, and projected company unit openings.\textsuperscript{170}

The prescribed format of the tables does not leave much room for practitioners in drafting Item 20; however, the FTC Rule does recognize that multiple events could impact one

\textsuperscript{163} FPRs have been covered in a variety of recent materials and full discussion of the particulars for FPRs is beyond the scope of this paper. See FINANCIAL PERFORMANCE REPRESENTATIONS: THE NEW AND UPDATED EARNINGS CLAIMS (Stuart Hershman & Joyce Mazero eds., A.B.A. 2009); Marisa Faunce & Jan Gilbert, Weighing the Risks & Benefits of Financial Performance Representations, Int'l Franchise Assoc. Legal Symposium (May 2012).

\textsuperscript{164} 16 C.F.R. § 436.5(t).

\textsuperscript{165} Id. § 436.5(t)(1).

\textsuperscript{166} Id. § 436.5(t)(2)(i).

\textsuperscript{167} Id. § 436.5(t)(2)(ii).

\textsuperscript{168} Id.

\textsuperscript{169} Id. § 436.5(t)(2)(iii).

\textsuperscript{170} Id. § 436.5(t)(3).
unit in a given fiscal year and counting those incidents in Tables 3 and 4 could be misleading. So, franchisors are permitted to use footnotes to describe such events. In addition, where Item 20 reports significant activity – such as a franchisor selling units to franchisees or purchasing units from franchisees, or a franchisee closing a number of units, franchisors often use notes following the table to explain the activity in the best possible light for the franchise system. These notes enable franchisors to artfully shape the franchisee’s perception of the data presented in Item 20.

The Compliance Guide includes an explanation for the various terms that are reported in Tables 2 and 3. While practitioners have some flexibility on how to report units, they should ensure that the reporting follows these explanations. Careful attention should also be paid to ensure that the system-wide totals in Table 1 match the totals for Table 3 and Table 4.

In addition to providing these completed tables, with some limited exceptions, a franchisor must disclose, for each franchised location, the franchisee’s name and the address and telephone number of the location. The information should be attached as an exhibit to the FDD, and the list should be organized alphabetically by state, and then, within each state, alphabetically by city. Franchisors should be sure to include, with some special designation or in a separate list, the franchise agreements signed but not yet opened. In preparing this list and the tables, practitioners should confirm that the list of units matches the number of units disclosed by state in Table 3.

The franchisor must also provide the name and contact information for any franchisee who left the system in the previous fiscal year or who has stopped communicating with the franchisor for at least the 10 weeks prior to the issuance date of the FDD. This list is broader than an initial blush suggests – it should include any franchisee that transferred a unit, any franchisee that closed a unit even if the franchisee continues to operate other units, and any franchisee who signed a mutual termination agreement. The FTC Rule requires disclosure of the business address and telephone number of the former franchisee, but permits franchisors to use the last known home phone number if the business information is not known. If the

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171 See Compliance Guide at 96: “Transfer” means the acquisition of a controlling interest in a franchised outlet, during its term, by a person other than the franchisor or an affiliate. It covers private sales of an outlet by the existing franchisee-owner to a new franchisee-owner and the sale of a controlling interest in the ownership of a franchise. “Termination” means the franchisor’s termination of a franchise agreement prior to the end of its term without providing any money or other consideration to the franchisee (e.g., forgiveness or assumption of debt). For example, a franchisor may decide to terminate a franchisee for failing to abide by system health and safety standards. As a result, the franchisee leaves the system without receiving any payment or other consideration, such as cancellation of a debt owed to the franchisor. “Non-renewal” means failure to renew a franchise agreement for a franchised outlet upon the expiration of the franchise term. For example, a franchisee may operate a franchise for period of 10 years. At the conclusion of the 10-year term, the franchisor (or franchisee) may decide not to renew the franchise agreement. “Reacquisition” means the return of a franchised outlet during its term to the franchisor in exchange for cash or some other consideration, including the forgiveness of a debt. For example, during the course of a franchise agreement, a franchisee may wish to terminate its relationship with the franchisor, and the franchisor may agree to buy back the outlet for cash or to forgive overdue royalty payments. “Ceased operation” means the cessation of business operations for any reason other than transfer, termination, non-renewal, or reacquisition. It includes abandonment of the outlet by a franchisee. It also includes franchisees in an “inactive” status.

172 16 C.F.R. § 436.5(t)(4).

173 Id. § 436.5(t)(5).

174 Id.
former franchisee requests, substitute contact information may be disclosed – including the home address, post office address or other personal or business email address. This list should reflect the units transferred and reported in Table 2 and the units terminated, cancelled, not-renewed, etc. in Table 3. In the list, practitioners also have the opportunity to state what happened to each unit.

State examiners have requested that the lists of current and former franchisees be included as exhibits to the FDD and not in the body of the FDD as part of Item 20.

The purpose of providing the contact information for former franchisees is to provide prospects with a ready source of individuals who have recently dealt with the franchisor. However, in some instances, in connection with ending the franchise relationship, the franchisor and the franchisee may execute confidentiality or non-disparagement agreements. If a franchisee has signed such a confidentiality agreement within the previous three fiscal years, the FTC Rule requires franchisors to disclose that franchisees have signed agreements limiting their ability to discuss certain topics pertaining to the franchise. The language is prescribed by the FTC Rule. However, franchisors have some leeway and may also disclose the number and percentage of current and former franchisees who signed such clauses.

If the franchise system has any qualifying trademark-specific franchisee organizations, certain information must be disclosed about those organizations, including contact information. Again, this provides the prospect with a ready source of information for the due diligence phase.

X. Item 21

Franchisors must provide audited financial statements prepared by an independent certified public accountant in accordance with generally accepted United States auditing standards. The statements must include a balance sheet for the previous two fiscal year ends and statements of operations, stockholders’ equity and cash flows for the previous three fiscal years. Franchisors can use their own statements or the statements of an affiliate. If the statements of an affiliate are used, the affiliate must agree to unconditionally and absolutely guarantee the franchisor’s performance and the signed guarantee must be referenced in Item 21 and included in the exhibit with the financial statements. Other requirements for the financials are that they must be in tabular form comparing at least two fiscal years, and if the

175 UFOC Guidelines at 65 n.10.
176 16 C.F.R. § 436.5(t)(7).
177 See id.
178 Id. § 436.5(t)(8).
179 Id. § 436.5(u)(1).
180 Id. §§ 436.5(u)(1)(i)-(ii).
181 Id. § 436.5(u)(1)(iii).
182 Id.
183 Id. § 436.5(u)(1).
franchisor (or affiliate) owns direct or beneficial interests in any subsidiary, the statements must be consolidated.184

The FTC Rule expressly recognizes that start-up franchisors are not likely to have the required audited financial statements. Accordingly, the FTC Rule provides for a phase in of the audited financial statements as follows: first partial or full fiscal year selling franchises – unaudited opening balance sheet; second fiscal year selling franchises – audited financial statements as of the end of the first partial or full fiscal year; third fiscal year selling franchises – all required audited financial statements for the second year and all previously disclosed audited financial statements.185 Start-up franchisors who phase in audited financials must prepare audited statements as soon as practicable, prepare unaudited statements in a format that conforms as closely as possible to audited statements and, if unaudited statements are used or three years of financial statements are not available, Item 21 must state that the franchisor has not been in business for three years and does not have the required financial statements.186

Under the FTC Rule, there is no room for art in this Item. The required statements must be included. Audited financials are expensive to prepare; accordingly, start-up franchisors generally seek to provide the bare minimum with the first FDD. However before doing so, the franchisor should understand the requirements of the various registration states. Specifically, notwithstanding the phase in of audited statements under the FTC Rule, some states have stricter requirements for financial statements included in the first FDD. For example, Minnesota,187 New York,188 Rhode Island,189 and Virginia190 may require a start-up franchisor to submit an audited balance sheet in its initial FDD filing. In these states, practitioners may be able to raise this issue directly with the examiner and request that the examiner accept something short of audited financials, such as reviewed financials. In addition, California specifically permits the Commissioner to waive the requirement for audited statements in extraordinary cases.191

185 16 C.F.R. § 436.5(u)(2).
186 Compliance Guide at 115.
188 N.Y. Comp. Codes R. & Regs. tit 13, § 200.8 (2002) (The law permits franchise examiners to request audited statements.).
191 Cal. Code Reg. tit. 10, § 310.111.2(d) (“In extraordinary cases the Commissioner may waive the requirement for audited statements if the statements have been prepared by an independent certified public accountant or independent public accountant and the Commissioner is otherwise satisfied as to the reliability of such statements and as to the ability of the franchisor to perform future commitments. Such waiver will ordinarily be granted only upon a showing that the franchisor has not had prior audited statements; that the close of the most recent or current fiscal year is so near the time of filing of the application that it would be unreasonably costly or impractical to provide audited statements with the application; and that audited statements will be furnished within a reasonable time after the end of the most recent or current fiscal year. In such cases the Commissioner may impose an impound condition and such other conditions and restrictions as in his discretion may be appropriate.”).
Franchisors should keep in mind that there may be limitations placed on the use of such statements by the states and they are not likely to permit the franchisor any leeway on the audited financial requirement after the first year.

Some of the art found in Item 21 comes from understanding which financial statements to provide. Franchisors should be aware of the impact of, among other things, a negative net worth, a going concern note, and qualified statements. Any of these issues with the financial statements can lead to comments by state examiners and the requirement of additional risk factors or financial assurances. In some cases, as with qualified financials, the state examiners will not accept the financials, requiring the franchisor to face the difficult choice of waiting for denial of registration by the state examiner, withdrawing the application, or restating financials.

Y. Item 22

The franchisor is required to disclose in Item 22, and attach to the FDD a copy of, all proposed agreements that a franchisee must sign in connection with the grant of the franchise and the opening of the franchised business. This Item is very methodical. Typical contracts that are referenced in Item 22 are the development agreement, franchise agreement, confidentiality agreement, guarantee, state addenda to agreements, compliance questionnaire, loan documents, option agreements, and real estate contracts. Remember, the FTC Rule requires the exhibits to the FDD to be referenced by letters not numbers.

Z. Item 23

Item 23 consists of two copies of a receipt used to evidence that the prospective franchisee received the FDD. Franchisors must include prescribed language on the receipt and provide information on the franchise sellers, the issuance date of the FDD, a list of the FDD exhibits, and a signature block with room for the prospective franchisee to sign and date the receipt. If not already provided in Item 1, the receipt must also give information on the franchisor’s registered agent. Franchisors have the option to provide return instructions for the receipt as well.

Since most of the language on the receipt is prescribed, the art comes into play in making the receipt page user friendly for the sales team. For example, the franchisor should assess the franchise sellers for the brand and determine the best way to ensure that the correct franchise seller is identified on each receipt page. There are a variety of methods to identify the franchise seller and the franchisor should carefully consider which manner is best course. For a franchisor that has one franchise seller, the seller’s name and contact information can be populated on the receipt page so that it does not need to be added later by the prospect or the

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192 16 C.F.R. § 436.5(v).
193 Compliance Guide at 27.
194 See 16 C.F.R. § 436.5(w).
195 See id.
196 Id. § 436.5(w)(4).
197 Id. § 436.5(w)(8).
franchisor. For a franchisor that has multiple franchise sellers, the receipt page can list multiple sellers (either on the receipt page or as an attachment) and the prospective franchisee can indicate all of the sellers that the prospect had contact with during the sales process.

Franchisors can also customize the signature blocks on the receipt pages for prospective franchisees. These blocks should reflect either the name of the franchisee who will enter the agreements with the franchisor or an agent or representative who the franchisee has authorized to accept the FDD.

The difference between the issuance date and effective dates bears noting. The issuance date is typically the date the franchisor finalizes the FTC version of the FDD. The effective dates are the dates by which the respective registration states approve the FDD for use in the state. On the receipt page, if the franchisor is using a state specific FDD, meaning that the FDD will only be used in the one registration state, the date on the receipt page should be the effective date provided by that state. If, on the other hand, the franchisor is using one FDD for all states, the date on the receipt page should be the issuance date and the state effective dates will be reflected in the state cover page at the front of the FDD.

The final customization of the receipt will be to include any FDD delivery requirements that differ from the FTC Rule’s 14 calendar day requirement. For example, currently Iowa, Michigan, New York, and Rhode Island have different requirements.

AA. Exhibits to the FDD

The exhibits to the FDD should be referenced in the body of the FDD using letters (rather than numbers). Many franchisors attempt to carry the formatting and fonts used in the body of the FDD through to the exhibits in order to present a uniform feel to the entire document. Since there is no prescribed order of the exhibits attached to an FDD, practitioners are free to organize the exhibits in the order that makes the most sense for the system and the orderly presentation of the required information in the FDD. Some options are: attach the exhibits in the order they are presented in the FDD; attach financials, agreements, and lists for Item 20 and then everything else; attach agreements first and financials last; and the list goes on and on. The franchisor will need to decide if there are documents that may not be technically required but that would be helpful for the prospect to review before signing. For example in hotel systems, some franchisors include a copy of the common documents a franchisee might sign such as lender comfort letter and voluntary termination agreements. Given that these documents are not technically required, a state examiner could request that the franchisor

198 Compliance Guide at 118.

199 Id.


204 Id. at 27.
remove the documents; however, in the event that the documents are helpful to the prospect the examiners are unlikely to do so.

III. THE ART AND SCIENCE OF MINIMIZING THE POTENTIAL FOR CLAIMS

A young rabbit once said, “If you can’t say something nice, don’t say nothin’ at all.” For better or worse, this adage does not apply to franchise sales. Federal and state franchise disclosure laws require franchisors to disclose certain information to prospective franchisees. Whether a franchisor says too much, too little, or something the wrong way, can be the basis of a claim by a franchisee against a franchisor. What, then, can a franchisor do to minimize the risk of such claims? In addition to complying with federal and state franchise disclosure laws, a better understanding of the franchisor’s duty to disclose information, and the franchisor’s ability to qualify the information provided, will aid the practitioner in drafting an FDD that will protect the franchisor against claims by franchisees.

A. The Franchisor’s Duty to Disclose

A prospective franchisee is given a lot of information during the course of the franchise sales process. In addition to an FDD, he or she has probably received a lot of marketing materials and brochures, had numerous phone calls with sales agents, and may have even attended a “discovery day,” during which time he or she was able to speak with the franchisor’s entire staff.

Of all the information that a franchisor may give to a prospective franchisee, what information is the franchisor under a duty to disclose to the prospective franchisee? All the information contained in the FDD? That is true, but not a complete answer. To answer this question, it is important to remember the contexts in which a duty to disclose arise. A duty to disclose can arise by statute. Here, we generally think of the various FTC Rule and state disclosure requirements standardized by the Amended UFOC Guidelines. However, this also includes franchise “anti-fraud” statutes such as the Florida Franchise Misrepresentation Act and anti-fraud provisions of franchise disclosure statutes, such as those in the Maryland Franchise Registration and Disclosure Law, which essentially impose upon the franchisor a duty to be truthful in all statements, both inside and outside of the FDD.

A duty to disclose can also arise when necessary to prevent a partial or ambiguous statement of fact from being misleading. For example, if, despite the franchisor’s stringent vendor approval policy, the franchisor’s salesperson says to a prospective franchisee, “you can buy chicken from any vendor you want if you talk to us first,” the franchisor may be under a duty to clarify this statement (which, presumably, would be accomplished in Item 8 of the FDD).

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206 Fla. Stat. § 817.416(2).


In addition, a party may be under a duty to exercise reasonable care in disclosing facts essential to a transaction if, due to the nature of the transaction, the other party would reasonably expect a disclosure of those facts. The Court of Appeals of Colorado seemed to allude to this principle in *Colorado Coffee Bean, LLC v. Peaberry Coffee Inc.* There, the defendant-franchisor did not disclose the financial woes of its parent company to prospective franchisees. The franchisor essentially argued that § 436.6(d) of the FTC Rule precluded the disclosure of financial statements of the parent company because the parent did not guarantee the franchisor's obligations under the franchise agreements.

The court found that the FTC Rule does not prohibit franchisors from providing truthful information outside of the FDD to prospective franchisees. The court further noted that the FTC did not intend for the FTC Rule to preempt common law claims and other state franchise practices laws (in other words, the FTC Rule sets a floor, not a ceiling, on disclosure requirements). Having rejected the franchisor's argument, the court went on to speak to the importance of this particular financial disclosure, stating that, "ongoing parent company losses could foreshadow [the franchisor's] insolvency, which could destroy the value of a franchise..."

The decision in *Colorado Coffee Bean* is consistent with FTC policy. In drafting the FTC Rule, the FTC recognized that important information may fall outside the scope of the FDD:

The Commission does not approve or express any opinion on the legality of any matter a franchisor may be required to disclose by [the FTC Rule]. Further, franchisors may have additional obligations to impart material information to prospective franchisees outside of the disclosure document under Section 5 of the Federal Trade Commission Act.

*Colorado Coffee Bean* and the FTC Rule suggest that the scope of a franchisor's duty to disclose can be exemplified by the following chart:

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209 Restatement (Second) of Torts § 551.
210 251 P.3d 9 (Colo. App. 2010).
211 Id. at 15.
212 16 C.F.R. § 435.6(d) states, “Do not include any materials or information other than those required or permitted by part 436 or by state law not preempted by part 436.”
213 Id. § 436.5(u)(v) instructs the franchisor to “include separate financial statements for the franchisor and any subfranchisor, as well as for any parent that commits to perform post-sale obligations for the franchisor or guarantees the franchisor's obligations. Attach a copy of any guarantee to the disclosure document.”
214 *Colorado Coffee Bean*, 251 P.3d at 23.
215 Id.
216 Id.
217 Id. at 22.
218 16 C.F.R § 436.10(a).
Disclosure of information outside of the FDD that the franchisor is under a duty to disclose (identified by the grey-shaded area of the chart) may not be streamlined by the franchisor. In other words, there may be no formal process in place to ensure that a prospective franchisee is given the information in the grey-shaded area. Even worse, such information may not be identified by the franchisor. So, arguably, the more information that falls in the grey-shaded area, the more susceptible the franchisor is to claims of fraud and misrepresentation based on an omission.

To mitigate the risk of an omission, should the franchisor include as much information as possible in the FDD? Certainly, the franchisor could rest easier if all information which the franchisor had a duty to disclose to a prospective franchisee was pre-packaged in a single disclosure document. However, there are several factors that an FDD drafter must consider before expanding the scope of disclosure in the FDD.

Perhaps most importantly, the FDD drafter must remember that there is simply a limit to the amount of information that may be included in the FDD. The FTC Rule states: “Do not include any materials or information other than those required or permitted by [the FTC Rule] or by state law not preempted by [the FTC Rule].”\(^{219}\) Thus, in parts of the FDD, such as the cover page, where the applicable rules require very specific information or exact language,\(^{220}\) there is little or no room to add.

However, there is an important caveat to the FTC Rule’s general disclosure limitation. According to the Statement of Basis and Purpose to the FTC Rule, “To the extent that a franchisor finds that its compliance with any particular disclosure Item may result in inaccurate or misleading information being furnished to a prospective franchisee, the franchisor may add

\(^{219}\) _Id._ § 436.6(d).

\(^{220}\) UFOC Guidelines at 31-32.
footnotes to ensure accuracy or to avoid misleading statements.\footnote{221} Although the FTC Rule does not limit the extent of their use, presumably footnotes must pertain to information that is required or expressly permitted by the FTC Rule. For example, the franchisor in \textit{Colorado Coffee Bean} would not have been able to include, in the FDD, a footnote about the financial performance of its parent company because such information does not clarify or qualify information that is required or expressly permitted in the FDD.

In addition to footnotes, the FTC has injected several other subjective elements into the FTC Rule. For example, there are Items in the FDD asking the franchisor to “include remarks, definitions, or caveats that elaborate\footnote{222} on information,” \footnote{223} to “provide additional information,”\footnote{224} to describe information in “general terms”\footnote{225} or “generally,”\footnote{226} and to make a “general description.”\footnote{227}

Adding another subjective element to the scope of information in the FDD is the concept of “materiality.” When the FTC Rule requires a franchisor to “disclose,” “state,” “describe,” or “list” something in the FDD, this means “to present all material facts accurately, clearly, concisely, and legibly in plain English.”\footnote{227} (emphasis added). The FTC Rule also includes an express “materiality” qualification for certain required disclosures in Items 3, 4, 8, 10, 13, 14, 17, and 19 of the FDD\footnote{228} The FTC does not expressly define “materiality” in the FTC Rule but suggests that a representation, omission, or practice is material if it is “likely to affect consumers’ conduct or decisions with respect to the product at issue.”\footnote{229} The FTC also states that materiality is “determined by the reasonable consumer standard, or in franchise matters, by the reasonable prospective franchisee standard.”\footnote{230}

Aside from the limitations of disclosure imposed by franchise law, there may also be information that the franchisor would simply prefer to keep private. With respect to information that the franchisor has an unequivocal duty to disclose, the franchisor’s preference for privacy matters little. However, in less clear cases, the franchisor must use its best judgment, based on an understanding of the duty to disclose principles and applicable case law, in determining whether, and how much, to disclose.

\footnote{221 FTC Statement of Basis and Purpose, 72 Fed. Reg. 15,444, 15,482 (Mar. 30, 2007) (hereinafter “FTC SBP”). See also Compliance Guide at 122.}

\footnote{222 16 C.F.R. §§ 436.5(f)(4), (g)(1)(i).}

\footnote{223 \textit{Id.} § 436.5(j)(1).}

\footnote{224 \textit{Id.} §§ 436.5(a)(6)(v), (g)(1)(iii), and (n)(7).}

\footnote{225 \textit{Id.} § 436.5(k)(5).}

\footnote{226 \textit{Id.} § 436.5(a)(6)(vi).}

\footnote{227 \textit{Id.} § 436.1(d); The UFOC Guidelines have a near-identical definition of these terms. See UFOC Guidelines at 29.}

\footnote{228 16 C.F.R. §§ 436.5(c), (d), (h), (j), (m), (n), (q), and (s).}

\footnote{229 FTC SBP at 15,455.}

\footnote{230 \textit{Id.}}
For example, in *Bonfield v. AAMCO Transmissions, Inc.*, the franchisor did not disclose to prospective franchisees that it had meetings with agents of the Attorneys General of Texas, Washington and Massachusetts, was informally requested to produce documents, and was served with two Civil Investigative Demands.\(^{231}\) The court found that the franchisor's failure to include this information in its UFOC was not an omission of a material fact in violation of the Illinois Franchise Disclosure Act because it would be highly speculative to infer that the franchisor was aware of "material investigative matters."\(^{232}\)

*Bonfield* is a case arising under the original federal franchise rule, which went into effect on July 21, 1979 (the "Original Rule").\(^{233}\) The Original Rule required the franchisor to disclose "any administrative...action...pending against him alleging a violation of any franchise law, fraud...unfair or deceptive practices...or comparable allegations."\(^{234}\) The FTC Rule has a similar requirement.\(^{235}\) A plain reading of the statute suggests that the scope of disclosure does not encompass, without more, meetings with Attorneys General, a request for documents or a Civil Investigative Demand (an investigation typically precedes an allegation).

In *Brosahd of Milwaukee, Inc. v. Dion Corp.*, a subfranchisor did not disclose to a prospective franchisee an attorney's opinion concerning a competitor's potential trademark and trade dress infringement.\(^{236}\) The Original Rule requires that the franchisor disclose "whether there are any infringing uses actually known to the franchisor which could materially affect the franchisee's use of such trademarks, service marks, trade names, logotypes or other commercial symbols in this State or State in which the franchise business is to be located."\(^{237}\) The court found that the franchisor's lack of disclosure did not amount to fraud in the sale of a franchise under the Wisconsin Franchise Investment Law because the subfranchisee had no duty to disclose the opinion—the attorney's views were opinions rather than material facts.\(^{238}\) Thus, similar to *Bonfield*, the court in *Brosahd* found no statutory duty to disclose by way of the UFOC disclosure requirements or the more general "anti-fraud" provisions.

The franchisor in *A.J. Temple Marble & Tile, Inc. v. Union Carbide Marble Care, Inc.* was not as fortunate.\(^{239}\) There the franchisee claimed that the franchisor's failure to disclose a preexisting plan to sell the franchise system upon the franchisor reaching certain financial


\(^{232}\) Id. at 593. See also *Layton v. AAMCO Transmissions, Inc.*, 717 F. Supp. 368, 371 (D. Md. 1989) (Failure to disclose Attorneys General investigations did not amount to fraud because the presentations were not "susceptible of exact knowledge at the time [they were] made...") (quoting *Vaughn v. Gen. Foods Corp.*, 797 F.2d 1403, 1411 (7th Cir. 1986)).


\(^{234}\) Id. at 59,725.

\(^{235}\) 16 C.F.R. § 436.5(c)(i)(A).


\(^{238}\) 1990 U.S. Dist. LEXIS 19992, at *51.

checkpoints was a violation of the “anti-fraud” provisions of the New York Franchise Sales Act. The franchisor insisted that the plan was more akin to a “proposal” for internal business purposes only and was not sufficient to constitute an actionable claim under New York law. Nevertheless, the franchisee’s claim survived the franchisor’s motion to dismiss.

It is important to remember that, with respect to avoiding fraud and misrepresentation claims, as with many things in life, sometimes less is more.

For example, in Simos v. Embassy Suites, Inc., the defendant franchisor preferred that it manage its franchised hotels, and considered whether the franchisee would agree to franchisor-management as a factor in choosing between competing franchise applicants, but did not disclose this preference in its UFOC. The plaintiff-franchisee alleged that the franchisor’s statements in Item 15 of the UFOC, regarding the requirement that the franchisee participate in the actual operation of the franchise, amounted to a misrepresentation in light of its management preference. The court disagreed, recognizing that “there is no evidence that [the franchisor’s] preference for corporate management foreclosed any participation in management by the [the franchisee].” The franchisee also alleged that the franchisor’s failure to disclose its management preference in Item 15 was an omission of a material fact that was necessary to make the statements made in Item 15 not misleading. Again, the court disagreed, noting that the “UFOC did not purport to speak on the criteria [the franchisor] would use in choosing between competing applications; it was silent on this issue.”

The following is a list of suggestions to drafters of an FDD in light of the duty-to-disclose principles and court decisions discussed above:

1) Do not simply err on the side of over-disclosure, as that can lead to a violation of franchise disclosure law and will not necessarily preclude fraud and misrepresentation claims.

2) Remember that a duty to disclose information to a prospective franchisee does not arise merely out of franchise disclosure law.

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240 Id.
241 Id. at 949.
242 Id. at 953. By contrast, in Vaughn v. Gen. Foods Corp., 797 F.2d 1403 (7th Cir. 1986), the franchisor’s failure to disclose a plan to sell did not amount to fraud.
243 983 F.2d 1404 (7th Cir. 1993).
244 Id. at 1409.
245 Id. at 1410.
246 Id.
247 Id.
3) Identify all information that the franchisor may be under a duty to disclose to a prospective franchisee.

4) Consider including additional information in the FDD through the use of footnotes and in Items of the FDD that permit greater discretion on the part of the drafter.

5) With respect to sensitive information that the franchisor would prefer to keep confidential, and to which the franchisor’s duty to disclose is not patently obvious, consider both the legal risk of non-disclosure and the business risk of disclosure.

6) Consider whether the information you are disclosing raises an affirmative duty to clarify your statements.

It is clear that the franchisor has a duty to disclose. But what about the prospective franchisee—does not he or she have a duty to investigate? This question was discussed in *Massey, Inc. v. Moe’s Southwest Grill, LLC.*

In *Massey*, the franchisee-plaintiffs brought, *inter alia*, fraud in the inducement, fraudulent omission, negligent misrepresentation and negligent omission claims against the franchisor for failing to disclose that its CEO was receiving allegedly illegal “kickbacks” from a supplier. Each of the franchise agreements stated that “[a]ny and all claims and actions arising out of or relating to this Agreement…shall be commenced within one (1) year from the discovery of the facts giving rise to any such claim.” Because the franchisees did not commence the lawsuit until several years after purchasing their respective franchises, the franchisor’s liability turned on whether the disclosures in the UFOC were sufficient to put the franchisees on notice of the “facts giving rise to any such claim.” In Item 8 of the UFOC, the franchisor stated that the CEO had a 50% equity stake in the supplier but did not state anything further about the relationship between the CEO and the supplier. The franchisees argued that, although they did not read the UFOC, they did not have a duty to read the UFOC and, therefore, could not be charged with notice of the statements contained in the UFOC.

While not going so far to say that the franchisee had an affirmative duty to read the UFOC, the district court found that a “reasonably prudent franchisee” would have read the UFOC and, accordingly, the franchisee’s mere failure to read would not preclude notice. The district court also noted that, under Georgia law, “[n]otice sufficient to excite attention and put a party on inquiry shall be notice of everything to which it is afterwards found such inquiry may

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249 *Id.* at *7.

250 *Id.* at *5.

251 *Id.*


253 *Id.*
Based on the statements in Item 8 of the UFOC, the district court concluded that the plaintiffs should have “diligently investigated” the CEO’s ownership further.255

On appeal, the Eleventh Circuit reversed the district court’s order that the Item 8 disclosure, as a matter of law, constituted discovery of facts giving rise to plaintiffs’ claims.256 Still, the Eleventh Circuit did not disagree that a reasonably prudent franchisee would have read the UFOC. Massey suggests that, once a prospective franchisee receives a copy of the FDD, he or she is on notice of all information contained in the FDD for purposes of limitations on claims, regardless of whether the prospective franchisee actually reads the FDD.

Also, while the district court may have gone a little too far in concluding that the franchisees had a duty to investigate impropriety between the CEO and a supplier simply because the UFOC stated that the CEO was a shareholder of the supplier, Massey provides some comfort to the FDD drafter that the prospective franchisees scope of “notice” may be broader than the scope of express disclosure in the FDD.257

### B. Disclaimers and Non-Reliance Clauses

The word “disclaimer” is thrown around a lot these days.258 Black’s Law Dictionary defines a disclaimer as “the repudiation or renunciation of a claim or power vested in a person or which he had formerly alleged to be his,” suggesting that a disclaimer is an express and affirmative repudiation of a right. For example, “I hereby disclaim the Warranty of Merchantability.” However, while we may see such affirmative statements in the franchise agreement, they are less akin to what is found in Items 1 through 23 of the FDD.

When used in the context of the FDD, disclaimers may be better described as “non-reliance clauses,” which serve to take away the franchisee’s right or power to rely on, or draw inferences from, statements or representations made to the franchisee prior to the sale of the franchise. These disclaimers are used primarily to counter fraud and misrepresentation claims by franchisees, although they may also prove helpful against breach of contract claims.260

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255 id. at *28.


257 See also Southside Smoothie & Nutrition Ctr., Inc., 2012 U.S. Dist. LEXIS 67620, at *30 (“Where the alleged misrepresentation relates to facts which could have been discovered upon investigation or inspection, and where the party alleging fraud has been granted the opportunity to conduct such an investigation or inspection before entering the contract, that party cannot subsequently complain that his consent was vitiated by fraud.”).

258 See e.g., Massey, 2012 U.S. Dist. LEXIS 109081 (Referring to the statement, “[w]e do not derive revenue, directly or indirectly, from any of these suppliers in connection with the services or products they provide to our franchisees,” as a “disclaimer.”).


It should probably be noted that, technically speaking, any statement made in the FDD can be deemed a “non-reliance” clause. For example, if the franchisor states on the cover page of its FDD that its address is “555 State Street,” that statement may be effective in taking away the prospective franchisee’s power to rely on the information to the contrary. However, for purposes of this article, when referring to disclaimers and non-reliance clauses, we are referring to statements that are typically understood to exist in the FDD for the purpose of qualifying representations or disclaiming reliance. We will also use the term “non-reliance clause” and “disclaimer” interchangeably.

One disclaimer commonly found in the FDD is as follows:

Your individual financial results may differ from the result stated in the financial performance representation.261

In theory, this disclaimer should preclude the franchisee from inferring that his or her financial results will match those disclosed in Item 19. And what would this accomplish for the franchisor? Suppose the franchise sale to the disclaimed franchisee was predicated on the franchisee’s genuine belief that his or her financial results would match those of the Item 19 figures. Further suppose that, twelve months after commencing operations, the franchisee is underwater. In a (franchisor’s) perfect world, even if the franchisor had intentionally inflated the Item 19 figures, the franchisee’s fraudulent inducement claim would fail because the franchisee could not have reasonably relied on those representations to infer his or her financial results.262

Of course, we do not live in a perfect, or a consistent, world. While some courts give deference to disclaimers in an FDD, other courts have long ago abandoned the idea that a franchisor can hide behind a disclaimer in the face of fraudulent conduct.263 Other courts take a more “equitable” approach and consider factors such as the specificity of the disclaimers,264 the intentional or reckless nature of the alleged misrepresentation, and the sophistication of the parties.265 Other courts have deemed statutory fraud claims immune to disclaimers,266 including

261 As required by 16 C.F.R. § 436.5(s)(3)(iv).


263 Victor Vital and Elizabeth Wirmani, Surviving the Amended FTC Franchise Rule: Merger and Integration Clauses, Franchise Agreements, and Disclosure Documents, 30 FRANCHISE L.J. 88 at *93.


266 Randall, 532 F. Supp. 2d 1071, 1088-1089 (disclaimers ineffective against anti-fraud provision of the Minnesota Franchise Act.); Long John Silver’s Inc. v. Nickleson, 923 F. Supp. 2d 1004 (W.D. Ky. 2013) (following Randall);
claims under the anti-fraud provisions of the Minnesota Franchise Act \(^{267}\) and the Maryland Franchise Registration and Disclosure Law. \(^{268}\)

Still, there are many reasons why a franchisor should pay close attention to disclaimers and non-reliance language in the FDD. For one thing, courts in many jurisdictions will dismiss fraud and misrepresentation claims as a matter of law due to effective disclaimer language. \(^{269}\) Also, even in jurisdictions that void disclaimers as a matter of law, a disclaimer may be used as evidence to support an argument that reliance on the part of the franchisee was not reasonable. \(^{270}\) Beyond jurisprudence, the FTC has taken great pains to increase the weight of statements in the FDD. For example, the FTC Rule expressly prohibits franchisors from disclaiming representations made in, or requiring franchisees to waive reliance on, the FDD. \(^{271}\) In addition, the FTC has stated that, “a prospective franchisee is entitled to regard as material each and every statement in a franchise disclosure document.” \(^{272}\)

However, one may ask whether disclaimers in the FDD are merely a product of following the letter of the law or a product of skill and technique on the part of the franchise lawyer. No doubt, in some cases, the FTC Rule or state franchise disclosure law mandates a specific disclaimer, which may not be modified. For example, on the cover page of the FDD, the FTC Rule mandates the following non-reliance language:

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. \(^{273}\)

In other cases, however, the franchisor is able to exercise some discretion in crafting non-reliance language in the FDD. For example, in Item 7 of the FDD, in disclosing the estimated initial investment of the franchisee, the franchisor is permitted to “include remarks, definitions, or caveats that elaborate on the information in the Table.” \(^{274}\) Therefore, it is not uncommon to see non-reliance language in Item 7, such as:

\begin{quote}
\end{quote}

\(^{267}\) Minn. Stat. § 80C.13.


\(^{269}\) Conway, supra note 267, at *324.

\(^{270}\) See e.g., Hanley, 2013 U.S. Dist. LEXIS 25340.

\(^{271}\) 16 C.F.R. § 436.9(h).


\(^{274}\) 16 C.F.R. § 436.5(g)(1)(i).
Your working capital needs may vary widely from working capital needs of other franchisees. It is expected that new businesses usually generate a negative cash flow. There is no assurance that you will not need additional working capital. Actual costs will vary depending on physical size and current condition of the premises. These amounts do not include sums necessary for living or personal expenses. The estimate does not include any finance charge, interest, or debt service obligation.

Another Item in the FDD where disclaimer language is helpful, and that affords the franchisor discretion for drafting, is Item 11. For example, the FTC Rule requires disclosure of the franchisor’s training program in a tabular format, broken down by subject, hours and location. A disclaimer that the franchisor’s training program is subject to change at any time may be important to a new franchisor or a franchisor that is making improvements to its training program.

In Olivieri v. McDonald's Corp., the prospective franchisee, after being kicked out of the franchisor's training program, sued the franchisor on a claim under the anti-fraud provisions of the New York Franchise Sales Act. Specifically, the prospective franchisee claimed that, because the franchisor had continuously changed its training program requirements, the description of the franchisor’s training program in the UFOC amounted to a misrepresentation. To the contrary, the court noted that the franchisor’s UFOC indicated that its training program was “fluid” and “constantly being revised.” Because the franchisor’s UFOC was not false or misleading, the prospective franchisee’s claim failed.

Sometimes the rules do not mandate, but still permit, specific disclaimers, which can be extremely important for the franchisor. One such disclaimer is found in Item 19 of the FDD and the importance of it is exemplified in the case of Overturf v. Rocky Mtn. Chocolate Factory, Inc. In Overturf, the financially unsuccessful franchisee claimed that the franchisor’s salesperson’s oral representation that “the franchise would be a suitable business for them” amounted to fraud. In dismissing the franchisee’s claim, the court found that the franchisee could not have reasonably relied on oral representations of the salesperson because, in addition to disclaimers in the franchise agreement, Item 19 of the UFOC stated, in bold, the following:

Except for the information in this item, no representations or statements of actual, average, projected, forecasted or potential sales, costs, income or profits are made to franchisees by us. We do not furnish or make, or authorize our sales personnel to furnish or make, any oral or written

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275 Id. § 436.5(7)(l).
277 Id. at 998.
278 Id. at 1000.
279 Id.
281 Id.
information concerning the actual, average, projected, forecasted or potential sales, costs, income or profits of a franchise or prospects or chances of success that any franchisee can expect or that present or past franchisees have had, other than as set forth in this item. We disclaim and will not be bound by any unauthorized representations.\(^{282}\)

The disclaimer language in *Overturf* comes out of a disclosure document drafted under the Original Rule and the amended UFOC guidelines adopted by NASAA in April 1993, which essentially went into effect on January 1, 1996 (the “1993 UFOC Guidelines”).\(^{283}\) Neither the Original Rule,\(^{284}\) nor the 1993 UFOC Guidelines,\(^{285}\) nor the applicable California regulations\(^{286}\) required the franchisor to include a disclaimer regarding unauthorized oral representations. The FTC Rule and Amended UFOC Guidelines do not expressly permit a disclaimer of unauthorized oral representations either unless the franchisor does not make a financial performance representation in the FDD.\(^{287}\)

Did the franchisor in *Overturf* violate the Original Rule or the 1993 UFOC Guidelines in making this disclaimer? Probably not then and, today, such language is also permitted by the FTC. Although not expressly permitted in the FTC Rule, FTC FAQ 27 makes it clear that a franchisor can disclaim oral representations in Item 19, provided that the franchisor uses the language prescribed by the FTC.\(^{288}\)

It has been suggested that Item 19 is likely the most litigated of the FTC Rule provisions.\(^{289}\) Therefore, one may argue that effective disclaimers and non-reliance language in Item 19 of the FDD will give the franchisor the most “bang for its buck.”

Other than the disclaimer on unauthorized representations mentioned above, what disclaimers, exactly, are permitted in Item 19? Under the FTC Rule and the Amended UFOC Guidelines, a franchisor that makes a financial performance representation must disclose “a clear and conspicuous admonition that a new franchisee’s individual financial results may differ from the result stated in the financial performance representation.”\(^{290}\) This “clear and

\(^{282}\) *Id.* at *14.


\(^{285}\) 1993 UFOC Guidelines at 57.


\(^{287}\) 16 C.F.R. § 436.5(s)(2); Amended UFOC Guidelines at 58.


\(^{290}\) 16 C.F.R. § 436.5(s)(3)(iv); Amended UFOC Guidelines at 59.
conspicuous admonition” was discussed further by NASAA in its commentary to the Amended UFOC Guidelines (the “NASAA Commentary”). In the NASAA Commentary, NASAA stated that, while no specific language is required under Item 19, franchisors should use the following admonition with respect to 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.

However, NASAA also made it clear that, “franchisors may not include additional language that serves to disclaim the financial performance representation they have just made or state that a franchisee may not rely on the information presented.” These instructions, and the differing opinions of state franchise examiners, seem to be the source of confusion over the scope of permitted non-reliance clauses in Item 19. It would appear that blanket statements to the effect of “we disclaim the information in Item 19” or “you may not rely on this information” are prohibited based on a plain reading of the rules. However, statements that the Item 19 information cannot be used to make estimates related to future performance, or cannot be construed as the actual or probable revenues, sales, profits or net incomes that will be realized by the franchisee, should be permitted. Likewise, statements that results will vary from location to location do not appear to disclaim Item 19 representations or waive reliance by the franchisee. However, at least one state examiner has required removal of the statement “we do not represent that you will attain these financial results” from Item 19.

Although the FTC Rule and Amended UFOC Guidelines do not always provide clear guidance with respect to the use of disclaimers and non-reliance language in the FDD, we can use them to derive some helpful tips:

1) When drafting, think about inferences that a prospective franchisee may be able to draw from statements in the FDD and think about possible qualifications that should be made to those statements as a result.

2) Focus your attention on Items of the FDD where greater drafting privileges are given to the franchisor, and those Items that are more prone to litigation, such as Items 7, 8, 11, and 19.

3) Remember to always include the disclaimer regarding unauthorized oral representations in Item 19, as permitted by the FTC in FAQ 27.

292 Id.
293 Id.
295 Id.
296 Id.
4) In anticipation of resistance from state examiners on the use of disclaimers, particularly in Item 19, keep your disclaimers specific and do not limit yourself to a single blanket disclaimer in a section.

IV. THE ART AND SCIENCE OF SELLING THE SYSTEM

The FDD serves an important role in the franchise sales process. Nearly every prospective franchisee will receive an FDD and will examine its contents for purposes of deciding whether to purchase the franchise or seek another opportunity.

However, the FDD is not necessarily a “sales tool”—that is, an instrument to promote franchise sales. In fact, for problem-plagued franchise systems, the FDD can be a hindrance to franchise sales. The FDD is a prospectus—an evaluation tool. There is little room for puffery and promotion.298 There is no fine print.299 It is difficult to cast things in a better light, downplay negatives and emphasize the positives. It does not appeal to emotions or capitalize on tendencies. It is not the result of a creative process.

What steps, then, can the FDD drafter take to create the most effective sales tool possible? One very practical, yet very important, goal in FDD drafting is professionalism. An FDD with spelling or grammar errors will reflect negatively on the franchisor and imply that the franchisor does not value quality or pay attention to detail.

Another important goal that will aid in selling the system is compliance with the plain English requirement of the FTC Rule.300 Although foreign to many lawyers, plain English is the language of salespeople. See supra Section II.A.1. for a definition of “plain English.” In the sales pitch, sales teams tend to talk in plain English - using clear, legible, and concise terms to explain the franchise system.

What about the use of puffery—“unique,” “opportunity of a lifetime,” “big money,” “best,” “exciting,” “interesting”—in the FDD? Because such words and phrases are difficult to quantify or peg as statements of fact, they generally cannot serve as the basis of a fraud or misrepresentation claim.

For example, in Brosahd, the franchisee claimed that the franchisor’s pre-sale claims that the franchise system was "unique" and one with "reputation, demand and goodwill" were actionable under the Wisconsin Franchise Investment Law because the franchisor did not disclose its attorney’s opinion doubting the franchisor’s effectiveness in preventing a “copycat” competitor from operating in the same area.301 The court noted that, under Wisconsin law, the question of whether a statement is one of fact or opinion turns on "whether the word or phrase is not capable of being either substantiated or refuted."302 The court also emphasized the context in which the statements were made and, in the sales and marketing context, such expressions

298 Compliance Guide at 122.

299 16 C.F.R. § 436.6(b)

300 Id. § 436.6(b) ("Disclose all required information clearly, legibly, and concisely in a single document using plain English.")

301 1990 U.S. Dist. LEXIS 19992, at *49.

302 Id. at *52.
are commonly thought to be “puffing” or “sales talk.” Accordingly, the franchisee’s claim was dismissed.

It may not be actionable at law, but is puffery permitted in the FDD? Although the FTC Rule does not expressly address puffery, it is probably wise to avoid using it. For one thing, the FTC prohibits “testimonials” and “promotional literature” in the FDD. In addition, given the FTC Rule’s express prohibition on superfluous content, puffery—which by definition neither constitutes fact nor has the ability to substantively qualify statements of fact—is arguably prohibited by inference. More generally, the use of puffery seems to frustrate the purpose of the FDD as an evaluation tool.

What if the franchisor has big plans that it would like to share with the prospective franchisee, such as a specific program to expand nation-wide or an anticipated new supplier relationship? Generally, at common law, words relating to future or contingent events are treated similar to puffery and, thus, are not actionable as fraud. This is true even as to statements of future profits or performance. However, there are several exceptions to this rule of which the FDD drafter should be aware. First, a statement as to future profits or performance may be actionable if the franchisor knew, or should have known, that the statement was false at the time it was made. Second, many state franchise statutes specifically include, as unlawful, misrepresentations of future performance. Third, some courts do not require a showing of fault on the part of the franchisor to sustain a fraud claim under franchise law (in other words, the statement need only prove to be untrue later). Therefore, the FDD drafter should not include the plans of the franchisor in its FDD unless the franchisor seriously intends to follow through with them and is actually capable of doing so.

The franchisor in Travelodge Int’l v. Eastern Inns had to learn this lesson the hard way. There, the franchisor, a west coast based company, told the prospective franchisee of its plan to have its hotel system expand up and down the eastern coast. Those plans did not

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303 Id. at *57-58.
304 Id at *59. See also Vaughn v. Gen. Foods Corp., 797 F.2d 1403 (7th Cir. Ind. 1986) (various statements by the franchisor eluding to the ‘viability’ of the system could only be characterized as ‘puffing’).
305 Compliance Guide at 122.
306 See e.g. Layton v. AAMCO Transmissions, Inc., 717 F. Supp. 368, 371 (D. Md. 1989) (representations regarding a franchise owner’s probability of success not actionable fraud because not “susceptible of exact knowledge”); Papa John’s Int’l, Inc. v. Dynamic Pizza, Inc., 317 F. Supp. 2d 740, 749 (W.D. Ky. 2004) (franchisees could not reasonably rely on statements concerning future events that were merely predictive);
307 Id.
308 2013 U.S. Dist. LEXIS 25340, at *63.
309 Fla. Stat. § 817.416(2)(a)
310 See e.g. Enservco, Inc. v. Ind. Sec. Div., 623 N.E.2d 416 (Ind. 1993) (declining to read scienter requirement into Indiana franchise fraud statute)
311 382 So. 2d 789 (Fla. Dist. Ct. App. 1st Dist. 1980)
312 Id. at 792.
materialize and the franchisee later sued for intentional misrepresentation under Florida law.\textsuperscript{313} Although the franchisor made a strong showing that its intentions were pure, the Court of Appeals of Florida did not find that evidence compelling enough to overturn a jury verdict in favor of the franchisee.\textsuperscript{314}

The FDD drafter will also aid in the franchise sales process by removing disclosures that are no longer required, with close attention to Items 3, 4, 6, 7, 13 and 20, where there is a high rate of information turnover. Including fees in Item 6 that are no longer imposed by the franchisor serves no purpose other than to make a prospective franchisee one fee less excited about purchasing the franchise. The franchisor does not want prospective franchisees calling a disgruntled ex-franchisee who never followed the system simply because Item 20 was not updated. Although the franchisor may not be sued or penalized for keeping the CEO’s old bankruptcy in the FDD, there is no benefit to disclosing it to a prospective franchisee. Also, remember that superfluous information is a violation of franchise disclosure law.\textsuperscript{315}

Following these simple drafting tips will aid in the franchise sales process:

1) Always check the FDD for spelling and grammatical professionalism.
2) Embrace the plain English requirement of the FTC Rule.
3) Resist any desire to include puffery in the FDD.
4) Exercise caution before including future plans in the FDD.
5) Take care to remove outdated information from the FDD.

V. CONCLUSION

A well-drafted FDD requires the drafter to take various resources—the FTC Rule, state law, the Amended UFOC Guidelines, published FTC and state agency opinions, and case law—and use them as a road map for drafting a disclosure document that complies with applicable disclosure law, aids in defending possible claims against the franchisor, and sells the franchise system to prospective franchisees. These resources are vast. It takes the FDD drafter a considerable amount of time to piece them together and understand how they dictate the substance of the FDD. Even with a thorough understanding of these resources, there is room for interpretation and discretion on the part of the drafter. It is in compiling, understanding, interpreting, and applying these resources that the art and science of FDD drafting come together.

\textsuperscript{313} Id. at 790.
\textsuperscript{314} Id. at 793.
\textsuperscript{315} 16 C.F.R. § 436.6(d).
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